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NOTE

Because of frequent changes taking place in the currency exchange rates in the world, figures have been quoted in local currencies only or in the currencies as quoted by local authorities. For purposes of comparison the following conversion rates have been used on a rough basis only in this report.

$US1	=	7.60 Indian rupees	-	£1	=	18.50 Indian rupees
$US1	=	5.05 Hong Kong dollars	-	£1	=	2.43 United States dollars
$US1	=	393 Korean Wons	-	£1	=	934 Korean Wons

CHAPTER I

What is a free trade zone?

Origin of free zones

The device of free zones is now more than two centuries old. Among the list of world-wide free trade zones prepared by UNIDO, a free trade zone is stated to have been set up in Gibralter as early as 1704. The free port of Hong Kong is also stated to have been set up in 1842, but it assumed a more useful role only after nearly one hundred years, that is, from 1947 onwards. Similarly, a transit zone was established in Bangkok as early as 1782. The free trade zone in Shannon was set up in 1947, but it only started functioning in 1964, when the first consignment of exports left the zone. This shows that there has always been a long gestation period between the setting-up of a free trade zone and the time when it actually starts humming with export industries.

Why is a zone called a free trade zone?

The word "free" in a "free trade zone" indicates freedom from customs duties and import taxes besides the import controls normally imposed by customs laws. The word "trade" indicates all types of commercial activities, including entrepôt trade, transit trade, storage, and distribution, besides the manufacturing activity allowed in the zone. The word "zone" indicates an enclosed area segregated from the customs territories and declared open for carrying out such "free trade" activities. All other penal and civil laws applicable elsewhere in the country, however, also remain applicable within the zone. The concept of free trade zone has since undergone very many changes in different countries of the world, which have used this idea by adding some additional incentives to make it serve more as a tool for promoting industrial growth, creating additional employment opportunities and earning much needed foreign exchange. The scope of the word "free" has, therefore, been enlarged to include freedom from payments of corporate and income taxes for a limited number of years. In addition, cash grants and other benefits are being extended. With the advent of the jet and jumbo aeroplanes, distances between continents have grown less and in this process, side by side with entrepôt trade, manufacturing activity purely for export has become a more dependable vocation. The emphasis thus shifted from "free trade" to "export processing", and these zones in many countries specializing in manufacturing activity only were named as "export processing zones".

Free trade zone and export processing zone

Today a number of terms are used in different countries with regard to free tra and export processing zones. In Shannon, it is called an industrial free zone, whil many others still prefer to call them free trade zones. What is important are the "freedoms and incentives" actually available inside the zone, and the objectives it achieves. Whether it is called a free trade zone or an export processing zone matte very little. But it should be recognized that it is a powerful economic weapon avai able to the developing countries today to attract industrial capital and the technic know-how of the developed world for their own benefit. This aspect is explained in greater detail below.

CHAPTER II

Development of free trade zones or export processing zones

Present position

Today there are approximately 200 free trade zones of various types and transit zones in the world. Nearly two thirds of these are in the developing countries, of which about 40 are in Latin America. The facilities offered in these zones differ f country to country but these can be divided into three main categories: (1) free t zones undertaking manufacturing activity purely for export; (2) free ports, like Hong Kong, in which part of the locally produced goods and those allowed for import allowed for domestic consumption also; and (3) transit zones, which provide bonded warehousing facilities. A free trade zone is always free of customs duties and impo controls. In addition, some zones guarantee complete tax exemption on export profit while others give cash grants for fixed assets besides ready-made factory buildings housing facilities for the workers. A free port encompasses an entire port area including the township, as in Hong Kong. In comparison to this, transit zones, whicl have mushroomed all over the world, are not strictly a device for creating additiona wealth and employment for the nation, but only serve as transit points. A list of tl free trade zones, free ports and transit zones existing in different parts of the wo is attached as annex I.

Device gaining popularity

The device of the free trade zone or the export processing zone is, however, nov becoming increasingly important for the developing countries as a tool for drawing upon the manufacturing expertise and marketing "know-how" of the developed world. A free trade zone can open up immense possibilities for creating additional wealth and employment opportunities which would have otherwise remained lost to the country. The mere fact that almost all the developing countries now wish to develop free trade zones of their own shows their eagerness to take advantage of this device. On the other hand, the international companies are also realizing that these free trade zones, at least some of them in the developing countries, provide excellent opportunities to develop new markets. The very fact that only three or four of these zones have so far developed successfully is, by itself, a sufficient answer regarding the conditions and climate that a foreign investor is looking for to set up an export industry.

Low share of developing countries in world trade

The share of the developing countries in the total world trade in manufactured goods is so very small, at present estimated at 15 to 16 per cent, that this by itself signals a danger to the trade of the developed world. The concentration of economic power and industrialized capital in the developed countries are creating problems of labour availability at economic costs, immigrant-worker problems, city congestion, pollution, and so on. There is thus almost unlimited scope available for the inflow of international investment of which the developing countries could avail themselves.

Free zones only prosper in a proper climate

Just as the proper soil, water and climate are necessary for the growth of a plant, there are certain prerequisites for the growth of export-oriented industries. An export-oriented industry in a free trade zone, with an obligation to export 100 per cent of its production, must have a modern, sophisticated technological base to compete with industries in more advanced countries. Of all things, advanced technology is a most difficult thing to obtain. Such advanced technology is generally available with foreign investment and the two demand a more attractive fiscal and financial climate than is available in their home country, or elsewhere. Given below is a brief account of the fiscal and financial climate created for development of export industries in the Shannon free trade zone in Ireland and the Masan free trade zone in the Republic of Korea, which are today considered to be successful experiments in this field. Another experiment of a slightly different kind, and on a magnified scale is that of the free port of Hong Kong. A brief account of Hong Kong's prosperity and its *raison d'être* is given separately.

CHAPTER III

Incentives and facilities available in some of the main free trade zones

Ireland - Shannon free airport

The Shannon Free Airport Industrial Estate is situated beside the Shannon International Airport and is 13½ miles from Limerick City. A new township is also being developed at Shannon, where the population at present is only about 5,000. Se transportation facilities for the import and export of cargo for the Shannon free zc are available through Limerick Port, which is 38 miles from the zone. Shannon Airpc is connected by very frequent air services to the principle cities of Europe and Noı America. Deliveries from Shannon can be arranged to all European airports within 24 hours. Daily cargo services are available between Shannon to New York, Boston, Chic and Montreal. Transportation is also privately arranged by exporters by chartered a craft. Shannon is served by many international airlines, such as Aer Lingus, Air Canada, British Airways, Irish International Airlines, Pan American World Airways, S Board World Airways and Trans World Airlines. The port of Limerick, which serves as seaport for the Shannon free zone, has regular shipping services to Europe and can accommodate vessels of up to 12,000 tons.

With the afore-mentioned infrastructure available, the following main financial other incentives are additionally available to the entrepreneurs setting up export industries in the Shannon free trade zone.

Financial and other incentives

(a) Total freedom from tax on profits generated by exports for 15 years, plus partial relief for the remaining years up to 1990. Capital profits or gai are not taxable. Trading losses are allowed to be carried forward indefinitely;

(b) Complete freedom from Government control over the investment of profits;

(c) Agreements for avoidance of double taxation with Austria, Canada, Cyprus, Denmark, the Federal Republic of Germany, Finland, France, the Netherlands Norway, Sweden, Switzerland, the United Kingdom of Great Britain and Northern Ireland and the United States of America. Agreements with Belgiu Italy, Luxembourg, Pakistan and Zambia have also been signed recently;

(d) Non-repayable capital grants up to 60 per cent of the total investment for small industries and 50 per cent for other industries;

(e) Liberal credit facilities for the rest of the fixed costs and working capital;

(f) Research and development grants of up to 100 per cent of the expenditure incurred by individual units;

(g) Built-up factory buildings and industrial housing facilities in and near the free trade zone area;

(h) Financial assistance to the extent of 100 per cent in the initial period of a new factory towards the cost of training workers and supervisors in Ireland and abroad;

(i) Liberal deductions in respect of depreciation of fixed assets in calculating profits for income tax;

(j) Duty-free access to the British market under terms of the Anglo-Irish Free Trade Agreement. (This has now become enlarged because of Ireland joining the European Economic Community together with the United Kingdom);

(k) A well-developed communications network in Shannon;

(l) The availability of a clearly well-defined and comprehensive legislation on free trade zones and foreign-investment policy, and a well organized smooth functioning organizational structure for the free trade zone;

(m) All the industries are committed to export 100 per cent of their production.

Republic of Korea - Masan free export zone

The Republic of Korea is situated between Japan and China, with an area of 98,500 square kilometres and a population of 33 million. The temperature ranges from 1.22°C in December to 24.6°C in August, which is the hottest month. Until 1950 the Republic of Korea suffered from economic stagnation and political instability, but with the successful implementation of their two five-year economic development plans (1962-1971), the economy experienced a dramatic expansion in both gross national product and exports. Along with these expansions the Republic achieved self sufficiency in heavy and chemical industries and solidification of agricultural development.

The Republic set up its first free export zone at Masan in 1970, with 427 acres of land area, where firms operating from foreign investment can manufacture, assemble or process export products, using tax-free raw materials and semi-finished goods. Within a period of four years, there are 113 such firms functioning in the zone and occupying nearly 95 per cent of the total area. Encouraged by the success achieved in this zone, the Republic set up another free export zone at Iri, in 1973, in 228 acres; nearly 70 light industries have already been admitted to this zone. The success achieved at such an amazing speed in these free export zones at Masan and Iri in the Republic of Korea is attributable to the following main incentives offered under their scheme for free export zones.

Financial and other incentives

(a) Income, corporate, property and property-acquisition taxes on foreign-invested firms are exempt during the first five years. A 50 per cent reduction is available for the subsequent three years;

(b) Business taxes on export business activities are entirely exempted;

(c) Taxes on dividends and surplus distributions accruing to foreign investor are exempt during the first five years and reduced by 50 per cent for the subsequent three years;

(d) Import duties, commodity taxes and so on on capital goods, raw material components and semi-finished goods imported are exempt in total;

(e) Income tax on the salaries and wages of foreigners engaged in occupant enterprises are all exempt;

(f) The remittance overseas of principle by foreign investors is guaranteed from the third year of business operation;

(g) The remittance overseas of profits and dividends by foreign investors is guaranteed from the first year of business operation;

(h) No restrictions are imposed on the import of raw material or equipment fo the production of export goods;

(i) There is a centralized administration with all powers for decisions relat to: the setting-up of industries in the zone; the import of plant, equi ment and raw materials; and all other related matters vested with the administrator of the zone;

(j) Ready-made factory buildings in the zone, and apartments for foreigners outside the zone, are provided by the zone administration;

(k) All industries in the zone are committed to export 100 per cent of their production to foreign markets;

(l) The zone administration arranges beforehand to provide to all occupant enterprises at the zone premises itself all supporting facilities and conveniences in: banking and insurance; transportation; warehouses; loading and packing; customs broker and trade services; repair machinery service; travel service; foreigners' commissary; apartments for foreigners (outside the zone); exhibition hall for products; informa tion centre for local raw materials; entertainment facilities, like a golf course and clubs, and so on.

Hong Kong - free port

A more detailed account of the free port system of Hong Kong is given separate in chapter IV. Here, for the purpose of comparison only, the main advantages avail and other conditions applicable to a foreign investor setting up export industries Hong Kong, are enumerated below:

(a) There are no tax holidays or special tax incentives in Hong Kong. There i however, a narrow and low tax base. Property, profits and interest are taxed at the standard rate of 15 per cent, while salaries are taxed on a sliding scale, with an overriding limit of 15 per cent;

(b) No tax is applied to income on profits arising abroad, even if remitted to Hong Kong;

(c) There are no non-repayable cash grants for setting up new industries available in Hong Kong, as there are in Ireland;

(d) There are no advance factory buildings or housing apartments made available by any agency in Hong Kong to attract foreign investors. The land in Hong Kong is available on a lease basis;

(e) No duties are levied on the import or export of various goods, except for three groups of commodities, namely: liquors and spirits; tobacco; and hydrocarbon oils, which are subject to excise duties. But all cargo stocks and materials of commercial value imported into and exported from Hong Kong must be declared. These are subject to a Trade Declaration charge of 0.5 per cent, which is for financing trade-promotion activities.

Although this study is limited to the organization of free export zones in Ireland, the Republic of Korea and Hong Kong, it may be useful to give some information on the functioning of the free export zones in Malaysia and the Philippines. As some of the free export zones in these countries have also made spectacular progress and, being situated near one another, have developed an interrelationship among themselves in competing with each other in the export markets, it is relevant to touch very briefly on the incentives and facilities given in these free zones also, so that a better picture of the facilities and incentives available in different free export zones in tthe region of the Economic Commission for Asia and the Far East is available.

Malaysia

Malaysia has designated two industrial estates at Bayan Lepas and Sungei Way as free trade zones to cater to the needs of export-oriented industries. Three more free trade zones are also being planned in Johore, Malacca and Kedah. Industries in the zones have the additional advantage of duty-free movement of goods in and out of the zone and with a minimum of customs formalities. Facilities are otherwise available on more or less the same basis to all foreign-invested export-oriented industries, whether inside the zone or outside it. The industries in the zone are committed to export 100 per cent of their production to foreign markets, while industries outside the zone may be obliged to export 70 to 90 per cent of their production. The main incentives offered to export-oriented industries in Malaysia are:

(a) Pioneer industries and export industries are exempt from the 40 per cent company tax and the 5 per cent development tax up to 5 years, extendable under special circumstances up to 8 years. The export-oriented electronics industry is eligible for nearly 10 years' tax holiday;

(b) Foreign investment in Malaysia is guaranteed against nationalization and political risk. Investment guarantee agreements have been signed with Canada, the Federal Republic of Germany, the Netherlands and the United States of America;

(c) There is no restriction on repatriation of capital and remittance of profit and dividends within the sterling area. Outside the sterling area, there i only nominal control;

(d) Double taxation avoidance agreements have been signed with Denmark, Norway, Singapore and Sweden, whose nationals have mainly invested in Malaysia;

(e) Export allowance for purposes of taxation, deduction from gross income is allowed at the rate of 5 per cent of additional export sales over and above the average annual exports during the preceding five years. In cases where export products incorporate local materials to the extent of 50 per cent, export allowance is allowed up to 8 per cent;

(f) Accelerated depreciation allowance companies exporting 20 per cent of their production and incurring capital expenditure for modernization are entitled to an accelerated depreciation allowance of 40 per cent per annum, includin an initial allowance of 20 per cent. This concession permits more than 90 per cent of eligible capital expenditure to be written off in approximat 5 years;

(g) Double deductions for export-promotion expenses all export-promotion expens incurred for overseas advertizing, supply of free samples abroad, export-market research, preparation for overseas tenders, negotiation and conclusion of contracts abroad, supply of technical information abroad, participa tion in approved trade exhibitions, expenses on advertising agents and publ relation consultants, qualify for deductions under Malaysia's Income Tax Act, 1967.

Philippines - Bataan export processing zone

The Bataan export processing zone comprizing 900 hectares for industrial purpose is located at the entrance to Manila Bay at the southern tip of Bataan province in Luzon Island. The zone is in a valley, 170 kilometres from Manila, and has a deep water bay. The main tax benefits and other incentives available to the zone enterprises are:

(a) Tax-free and customs-duty-free importation of machinery, equipment, raw materials and supplies;

(b) Exemption from payment of export tax;

(c) Exemption from payment of municipal and provincial taxes;

(d) Net operating loss incurred in the first five years of operation may be carried over as deduction from taxable income during the succeeding five years;

(e) Accelerated depreciation of fixed assets deductible from the taxable income;

(f) Fully foreign-owned enterprises permissible in the zone and foreign nationals having at least $US100,000 investment in the zone, may reside in the Philippines as long as their investment remains there;

(g) Repatriation of foreign investments and the remittance of profits and dividends are allowed at any time in full, at prevailing exchange rates;

(h) Simplified administration procedures include all powers vested in the zone administration, which assures release of all imports and exports within 48 hours;

(i) Standard factory buildings available at reasonable rentals or for outright purchase;

(j) All other services and facilities, like banking, insurance, cargo handling, transportation, medical, housing and recreation facilities, assured on the spot by the zone administration.

India - Kandla free trade zone

The Kandla free trade zone, comprising 320 acres of land, is located on the west coast of India, near the newly established major seaport of Kandla. The main tax benefits and other facilities available to the export industries in the zone are:

(a) Plant, machinery and raw materials imported for the production of export goods are exempted from customs duty. Similarly, no excise duty is levied on indigenous materials used for export production in the zone or on goods manufactured in the zone for export to foreign markets;

(b) New industrial undertakings going into production up to 31st March 1976 will be exempt from income tax on their incomes up to 6 per cent of the capital invested under specific conditions. Development rebate at specified rates is also admissible to industries in the zone, as elsewhere in India;

(c) Foreigners are permitted to make investments up to 100 per cent in any form of trading and industrial enterprises in the zone;

(d) Repatriation of profits after payment of taxes freely allowed;

(e) Foreign exchange holdings permitted to be brought into the zone and separate non-resident accounts maintained;

(f) Full freedom to import on a duty-free basis, plant and machinery and raw materials against a non-resident's own foreign exchange resources;

(g) Repatriation of capital invested by foreigners in the zone allowed on a liberal basis;

(h) The zone administration offers some preconstructed sheds and developed plots of land with an adequate supply of water and power and other related facilities, such as railway sidings, and so on;

(i) For resident industrialists, advance import licences to cover 12 months' raw material requirements are given by the Government;

(j) No tax holidays or cash grants of any kind are offered in the zone.

This zone, set up in early 1967, has not been a great success. About 20 industrial units, mostly of small-scale size, owned and managed by Indian nationals, are present functioning in the zone, with an annual export turnover of Rs.10 million, th is, about £500,000. There is no foreign investment in the zone; State investment c the development of the zone is about Rs.12,500,000, or £625,000. The original expec tion that industries in the zone would help to develop the industrial infrastructure the region, and generate cargo traffic at the Kandla seaport, have apparently not be realized.

Santa Cruz export processing zone

Another export processing zone for electronics has recently been set up at the Santa Cruz Airport at Bombay. This zone, at present on 100 acres with sufficient la for expansion, carries the same facilities and incentives as Kandla, but with one bi difference, its location. Bombay is one of the busiest commercial centres in the wo and is on the international air and sea routes. Bombay can offer a large pool of skilled manpower and technical personnel at low cost, as well as close links for the zone industries with the component-making facilities already well developed in the Bombay area. Up to September 1973, 14 firms had been approved to set up industries the zone, out of which six had foreign equity participation, ranging from 40 per cen to 55 per cent. This zone had a good start, and more foreign firms are expected to come in shortly. The great advantage of this zone is therefore its location in a pc city having a well developed commercial and industrial base, though the tax benefits cash grants and other related facilities offered in many other free trade zones in t ECAFE region far outweigh those offered in the Santa Cruz export processing zone.

CHAPTER IV

A critical analysis of causes of success achieved in Shannon, Masan and Hong Kong

The account given in chapters II and III describes briefly the background, toge with fiscal and financial incentives available, particularly in Shannon, Masan and Hong Kong, which are specifically considered today as the most successful experiment in free trade zones in the world. The reasons for the extraordinary success achieve in these three places are now analysed very briefly. This will also show the basic locational advantages which they have and the amount of capital investment and human effort that have gone into these zones to benefit from locational advantages.

Reasons for the success of the Shannon free trade zone

Advantage from situation

Ireland has the exceptional advantage of being situated very close to the British and European markets. It is also between Canada and the United States of America on the east side and the European Economic Community on the west. Before the jet aeroplanes came in the 1960s, Shannon Airport was the fueling station for all aircraft coming from North America to the United Kingdom and Europe. Thus Shannon had already become a major halting station for all the international airlines. Later, when Shannon emerged as a manufacturing centre, its nearness to the United Kingdom and Europe and the fact that it lies between Europe and the United States of America involved low transportation costs in the movement of materials to Shannon, and of finished goods from Shannon to Europe and the United States of America which are its main markets.

Industrial climate in the country

The over-all industrial climate in Ireland was made very attractive for the inflow of foreign capital and technology. Almost the same incentives and tax holidays are available for export industries set up anywhere in Ireland. The only additional advantage available in the Shannon free trade zone is the more streamlined procedures, less documentation and duty-free imports of materials and equipment. Actually, the development of the Shannon free trade zone is closely linked with the over-all industrial development of Ireland as a whole. No doubt any free trade zone in such favourable circumstances would do well.

Traditional links with developed countries

Because of lack of employment, many Irish people had emigrated earlier to Canada, the United Kingdom and the United States of America as well as to various countries in Europe, to seek better opportunities. Quite a number of them grew prosperous abroad, and a flow of investment to Ireland took place easily and quite fast.

Availability of suitable labour

Ireland is able to provide an adequate number of educated and adaptable workers suitable to the requirements of industry; being close to European and British markets, with well-developed facilities and suitable labour available, Ireland became the ideal place for international investment by multinational companies.

Heavy package of incentives

The Irish Government recognized as early as 1958 that the country could not b industrialized without attracting foreign investment. A foreign investor is looki for only one thing, and that is "higher profits". For this purpose, a heavy packa of financial incentives was introduced, as explained in chapter III (first part).

Well developed communications network in Shannon

Shannon has rapid access to major European centres within less than two hours flight range. It has a fairly well developed translantic terminal, and transit passenger and freight traffic consisted of nearly 950,000 passengers and 10,000 to of cargo in 1973.

Well developed organizational structure for the free trade zone

Authority for the development of the Shannon free trade zone is vested in an autonomous State-sponsored company called the Shannon Free Airport Development Com It has a part-time Board of Directors with a full-time chief executive, who is the chairman of the company. All decisions regarding setting up industries, and the i of plant and machinery and raw materials, are taken at Shannon. The role of the Government is limited to enacting legislation and setting broad national policies regarding financial incentives, and so on to be given, for which funds are provide annually by the Government.

Comprehensive legislation

Lawful powers for developing the free trade zone and giving necessary financi incentives were obtained through the Customs Free Airport Act 1947, followed by a Amendment Act in 1958, the Finance Miscellaneous Provisions Act 1958, the Shannon Airport Development Company Act 1959, and time-to-time amendments on those Acts in 1961, 1963, 1965 and 1970. Since there was no previous experience available, leg powers were obtained in a piecemeal manner; however, fairly comprehensive powers to have been acquired now for the smooth performance of tasks.

Tourism used effectively for free trade zone development

The Shannon Free Airport Development Company is constantly striving to incre the tourist traffic to the Shannon region by various methods, such as charter fli renting Irish cottages, mediaeval castle banquets and so on, as they believe that people coming on holiday and seeing for themselves the business opportunities ava come again subsequently as prospective investors.

Heavy State investment

Besides the tax holiday which is a trump card in the Irish industrialization programme, heavy sums of money are being spent by the Government to encourage export industries in the zone. The second biggest incentive is the non-repayable cash grants up to 60 per cent of the total investment outlay in industries. It is understood that nearly £3,500,000 has already been distributed to the industries in the zone so far as cash grants. The Government has spent nearly £8,600,000 on the development of the site and for the construction of factory buildings in the zone. Another sum of £8,700,000 has been spent for developing housing facilities for workers near the zone. Accordingly, the State investment in the development of the Shannon Industrial Estate, Airport, and Shannon Township, is estimated at about £35 million, out of which £14,200,000 is in the zone. As against this, the total foreign private investment in the zone at present is of the order of £13 million and Irish private investment is £1,100,000. This total investment of over £28 million in the zone has created employment for 7,525 persons at present engaged in and around the zone, and net foreign exchange earnings of £86,300,000 during the last nine years of the existence of the Shannon free trade zone. Detailed statistical tables supporting the figures quoted above are given in annex II.

This heavy input of capital resources in the zone has to be viewed further in the national context of Ireland as a whole. As already stated above, Ireland has situational and other basic advantages which cannot be reproduced in any way by another country. These basic advantages, combined with financial incentives in the form of tax holidays and cash grants, which were fairly attractive, made the zone successful. But a glance at the over-all figures of foreign investment and the new heights of industrialization and export performance achieved by the country as a whole, reveal that success achieved in Ireland is much more than what has been achieved in the Shannon free trade zone. Below are estimates of foreign investment at present in Ireland as a whole:

	Million pounds
Federal Republic of Germany	16.6
The Netherlands	36.0
United Kingdom	43.1
United States of America	86.3
Others	38.0
Total	220.0

Out of their total annual exports of about £630 million, manufactures account for £270 million, more than 50 per cent of which is by foreign companies now having inv ments in Ireland. This, in other words, means that a net additional foreign exchar earning of £135 million annually has been created, along with vast employment oppo nities - through the devices of tax holidays and cash grants - which would have otl wise remained untapped.

This analysis leads us to the conclusion that the success achieved at the Shar free trade zone is at a heavy capital cost, which comes to nearly £7,000 per persor directly employed in the zone. The net foreign-exchange earnings generated by the during the last nine years at £86,300,000 also appear to be low when compared with total State and private investment standing at £53 million in the zone.

The second point which emerges from this analysis is that the industrial clima and conditions in Ireland as a whole are quite conducive for the inflow of foreign investment in the export industrial sector. The figures quoted above clearly illu that the record of foreign-invested industrialization and export performance of Ireland as a whole is more impressive, and the Shannon free trade zone perhaps als gained in the over-all strides achieved in the country. It will therefore be appr priate to draw the conclusion that the over-all industrial climate in the country more important for developing a free trade zone with 100 per cent export-oriented industries. Countries with certain peculiar industrial or political conditions ca expect much from their newly created free trade zones, even when loaded with heavy incentives, if foreign capital does not flow in because of these conditions.

Reasons for the success of the Masan export processing zone - Republic of Korea

The reasons for the success of the Masan export processing zone are similar t those for the Shannon free trade zone, as indicated below:

Advantage from situation

The proximity of the Republic of Korea to Japan is one of its main basic adva and the Koreans have done well to cash in on it. Contact established with Japan i most rewarding factor in the Republic's economy. Masan, where the first free trad was set up in 1970, is near the Busan seaport, which is only 45 minutes by air fro Osaka. There is heavy Japanese tourist traffic to the Republic of Korea and many these tourists, while enjoying their holidays there, see the commercial prospects return later as potential investors to set up new industries. Out of 113 industrial units functioning in the Masan export processing zone today, 105 are owned by Japanese. The next biggest foreign investors in the Republic of Korea are American firms.

Availability of suitable labour

Due to their comprehensive educational system, over 90 per cent of Koreans are literate. Because of the rapid increase in technical and vocational schools, skilled workers are available in almost all fields. The money wage rates are still low, compared to west European and Japanese standards. This attracts a large number of Japanese investors, for whom there is land nearby where cheaper and capable labour is available, besides the tax holidays and Government assistance. Foreign investors look for such facilities.

A good package of incentives

The package of incentives introduced by the Government to attract foreign investment and technology into the Republic and particularly into the free trade zones, cannot be considered heavy, as is the case in Ireland, but it is attractive enough for the inflow of Japanese investment. Commercial capital in Japan, which is the only developed country in the Far East today, has reached saturation point, and it has to look outward for profitable investment. Suitable benefits and opportunities in the form of tax holidays and low rates of taxation, low money wage rates and active government assistance in the form of ready-made factory buildings and cash grants, and so on, were available in certain nearby countries. Accordingly, it found outlets in the Republic of Korea, Hong Kong, and others. Many Japanese firms producing in the Masan free trade zone in the Republic control distribution and exports from Tokyo.

Industrial climate in the country

The industrial units in the country are export-oriented. Each industrial unit has to earn its own foreign exchange. There are no actual users' import licences available and the industrial establishments, having no export performance, have to buy their import licences in the open market at a premium. The second main feature of the Republic's economic policy is the Foreign Investment Inducement Law. Under this law, the admissible tax exemptions and reductions in income tax and corporation tax have all been clearly defined in one place. Although the country does not have a narrow tax base, like Hong Kong, still the entire picture is available in precise terms in one place, and all kinds of literature are available to convince the foreign investors

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that the Republic of Korea is the most attractive place for starting a new industry, so far as benefits under tax laws and government assistance and lower money wages ar concerned. The country's outstanding economic growth is attributable to three main factors, namely, the smooth inducement of foreign capital, expansion in industrial products, and increase in exports. Exports rose at an annual average growth rate of 40 per cent during 1962-1972, reaching 1,624 million dollars, an increase of 40 time over the low base of 41 million dollars in 1961. In 1973 exports rose to 3,200 mill dollars, which is an achievement over which the Koreans themselves express surprise. When the country as a whole is making such rapid strides in economic progress and export performance, there is no reason why its free trade zone, which only offers mc liberalized arrangements for undertaking export production, should not also achieve similar success.

Comprehensive legislation

The Government passed a special law in 1970, under which the Masan free export zone was established. Under this legislation the facilities and incentives availab! in the zone, besides the powers of the zone administration and privileges of the fo: investors, were clearly defined.

Heavy State and foreign investment

The Government has so far spent nearly £10,300,000 on the development of the Ma free export zone, which today incorporates foreign investment of the order of £35,3(and domestic investment of the order of £3 million. This total investment of £48.6 million has generated employment opportunity for 23,334 persons, and annual export earnings in 1973 of £30 million. The net incidence of this capital outlay in the M free trade zone comes to nearly £2,000 per person employed in the zone, which, in a case is much lower compared to Shannon, where, as already stated, it comes to nearl £7,000 per person employed in the zone. Thus the advantage of comparatively cheap labour has been utilized.

Hong Kong - free port

Hong Kong has a total land area of slightly over 400 square miles, consisting Hong Kong Island, of about 25 square miles, Kowloon Peninsula, of about 5 square mi and New Territories, consisting of about 370 square miles. Between Hong Kong Islan and Kowloon Peninsula lies Victoria Harbour, which ranks with San Francisco and Rio de Janeiro as one of the three most perfect natural harbours in the world. The climate is mild, and the daily temperature ranges from 15°C in February to 28°C in July, which is the hottest month in the year. The population now stands at 4,200,000, compared to only 3,100,000 in 1961. Nearly 99 per cent of the population are Chinese. Apart from its deep water harbour and strategic geographical position, Hong Kong has virtually no natural resources. It is often said that the prosperity of Hong Kong lies mainly in the skill and intelligence of its people, and the careful balancing of fiscal and financial policies introduced by the Government, resulting in the industrial momentum obtaining in Hong Kong. Until the 1950s the economy depended very largely on entrepôt trade between China and the rest of the world, which gave rise to excellent banking, shipping, warehousing and insurance facilities. It was only in the 1930s that industries were introduced into Hong Kong on a small scale. In 1950, exports of domestic products were estimated at 25 per cent only of the total exports, while the remaining 75 per cent comprised re-exports. The position was competely reversed in 10 years, and in 1960 exports of domestic products comprised 73 per cent of the total exports, while in 1972 their share further increased to 79 per cent. According to official estimates, nearly 85 per cent of the goods produced in Hong Kong are now exported to foreign markets.

It is quite evident that the progress achieved in Hong Kong during the last 20 years is not only impressive but also remarkable. One is naturally inquisitive to know what are the main determinants of Hong Kong's economic progress and development. The following three determinants are mainly responsible for Hong Kong's economic progress:

<u>Industrialization based on competitiveness and specialization</u>

A high rate of population growth, while the people are conscious all the time that Hong Kong has no natural resources of its own and the only way to survive is through "industrialization". Furthermore, their industrial growth has to be mainly export-oriented, as there is not enough domestic market available. Such export-oriented industries could sustain themselves only if they have a high degree of built-in "competitiveness and specialization";

<u>Carefully balanced fiscal policies</u>

To achieve the objective indicated above, the Government should have the correct fiscal policies which would help achieve the objective as quickly as possible. The "concepts of free enterprise, free port and low rates of direct taxation" were tact-fully combined with the prevailing low money wage rates and complete freedom on the inward and outward movement of capital, and this turned Hong Kong into one of the most attractive places for investment in the world.

Automatic corrective mechanism

Lastly, the automatic corrective mechanism in the economic system of Hong Kong : perhaps the real secret of Hong Kong's success. Twenty years ago, money wage rates : Hong Kong were among the lowest in Asia. Today they are among the highest, but stil: there is no employer and employee confrontation, or latent hostility and lack of tru: in the labour market. The reason is that, while the money wage rates have gone up, · productivity of labour has also gone up very substantially, Hong Kong's manufacturi: industry has tended to concentrate on the production of a rather narrow range of commodities and the strength of Hong Kong's industries lies in the fact that it larg turns out those finished products which are in demand in the most sophisticated consumer-oriented communities in the world. Hong Kong's growth, therefore, continue to depend on its export performance.

The rising money wage rates have, however, set a new trend in Hong Kong's econo and that is to rearrange the industries for the production of only those high-qualit products that will be above the range of competition which Korea, the Philippines, Singapore and Thailand have started offering because of their lower money wage rates· To what extent Hong Kong will be successful in achieving this remains to be seen. B a perusal of the statistical data in annex IV (provided by the Hong Kong Trade Development Council) brings out the following three points which deserve attention.

(a) The number of tourists visiting Hong Kong in a year is almost equal to 25 per cent of the total population. Tourism is, therefore, their biggest money-spinner today. Shops in the streets glitter until late at night, presenting a panorama of products produced all over the world, and particularly their own products;

(b) Hong Kong's industrial situation is a rather desperate one today. The ready-made garments industry and the textile industry, which were the mainstay until recent times, have already reached saturation point. No new textile units are being set up in Hong Kong. Ready-made garments and textiles together constitute nearly 50 per cent of the total exports; But industrial units in the free zone of the Republic of Korea, backed by foreign investment and equally modern technology, but lower money wage rates, have already started offering stiff competition. India and Pakistan are also offering stiff competition to Hong Kong's textiles and ready-made garments. The only way for the industry to survive is, therefore, to produce high-quality materials and garments which its competitors will take time to copy. Plastics and plastic products constitute about 10 per cent of their total exports, and almost all the surrounding industrialized countries are offering stiff competition. The next most importa industry today in Hong Kong is electronics, which also constitutes about 10 per cent of their total exports. In this field also the Republic of Korea, and Singapore are offering very stiff competition. Electrical products and metalware constitute about 2 per cent each of their total exports. In these items also stiff competition is being offered by almost all the surrounding industrialized countries. Footwear and travel goods, which constitute about 2 per cent of Hong Kong's total exports, are already going down in the face of stiffer competition from the Republic of Korea and others;

(c) The foregoing clearly illustrates that Hong Kong's industry is not in a stable condition and is under constant threat from its competitors. Furthermore, the money wage rates in Hong Kong are today three times as high as those of the Republic of Korea and twice those of Malaysia. Despite this, Hong Kong's annual growth rate has been rising continuously. In 1950, their exports stood at HK$1,000 million, which increased to HK$19,500 million in 1973. A Table reveals some interesting facts:

Table 1

Growth rate of products exported from Hong Kong from 1950 to 1973

Year	Exports (HK$ million)	Employment (personnel)	Annual growth rate (%)	Products
1950	1 000	100 000	-	Low-quality garments, footwear, metalware
1960	2 000	220 000	15	As above; plastics industry started
1970	10 500	530 000	25	Improvement in quality of products; started electrical and electronics industries
1973	19 500	620 000	26.5	Concentration on sophisticated industries, such as electronics and high-quality garments

The following are some of the main factors responsible for the sharp increase in Hong Kong's export performance and employment position:

(a) Industries diversified their products faster than their competitors;

(b) Concentration on requirements of the European markets. Similarly, specific requirements of markets in East European, African and South American countries are being intimately studied and products adapted to suit their tastes and needs;

(c) Export promotional activity was intensified with the setting up of the Trade Development Council;

(d) Taxation rate at 15 per cent of the gross profit is considered the lowest in the world. There is no double taxation in Hong Kong, and branches of Hong Kong firms abroad are not taxed in Hong Kong. Normally the income-tax rate in surrounding countries like Japan, the Republic of Korea, the Philippines, Singapore and Thailand ranges between 30 to 60 per cent;

(e) Liberal tax concessions are available for research and development, which enable the companies to achieve higher and higher quality standards and t develop new products;

(f) Subcontracting facilities are available in Hong Kong and a company need not set up a whole plant. Links within the industry are also available i plenty, with the result that supporting industries are very attractive to small-scale entrepreneurs in Hong Kong;

(g) Because of the greater freedom available on the movement of capital in an out of Hong Kong and the low tax rate, a large number of firms from Japan the Netherlands, Switzerland, the United Kingdom and the United States of America brought in huge foreign investments, along with their superior technical know-how. This inflow of foreign capital and technology is the main cause of Hong Kong's booming prosperity and industrial growth.

However it should be mentioned that Hong Kong is not a free port at all, and to cal a "free port" is a misnomer now. A free port, by definition, envisages complete ta exemptions and freedom from customs duties and controls for goods imported or expo and the registration of traders, and so on. Today's Hong Kong is very much a contr economy, like any other port, because of the following factors:

(a) There are no tax holidays or special tax incentives in Hong Kong. Earnin and profits taxes are broken down into property, profits, salaries and interest taxes. All these, except salaries, are charged to tax at the standard rate of 15 per cent, while salaries are subject to a sliding scale of tax from 5 per cent to an overriding limit of the standard rate 15 per cent;

(b) Under the Business Registration Ordinance every person, firm or corporati which carries on business in Hong Kong must register with the Ministry o Commerce and Industry on payment of a registration fee of HK$25. Regist tion of all manufacturers and traders is done by the government departme of Commerce and Industry, which also deals with all commercial complaint received from buyers abroad;

(c) Excise duties are also levied in Hong Kong on three groups of commoditie namely tobacco, alcoholic liquors and hydrocarbon oils, whether imported or locally manufactured;

(d) There are a number of other charges, such as stamp duty, motor vehicles registration tax, land rates and court fees.

Despite all these controls and taxes, Hong Kong still continues to be known t world as a "free port". Various industrialists in Hong Kong comment that, despite controls and taxes, the sting of taxation is still very low in Hong Kong, compared other places, and that they are there because of low taxation, good infrastructure abundant availability of well trained and disciplined labour to whom "strikes" are unknown. This is precisely what a foreign investor is continuously looking for to mize his production costs and maximize his profits. This explains convincingly th secret of the success of Hong Kong.

CHAPTER V

Import factors/considerations for setting up a free trade zone

It would not be appropriate to lay down any drill for the successful development of an export industrial estate or a free trade zone, as each country has to devise a programme of action, keeping in view its own special circumstances of the geographical, political and industrial situation obtaining in the country. Still, there are some basic important factors which, if used properly, can go a long way towards speeding up the development of industries in the zone. The more important of these factors are the location of the zone; the package of incentives offered in the zone, a clear analysis of industries more suitable for development in the zone and the vistas of international subcontracting proposed to be achieved in the zone; clear legislation for implementation of the free trade zone scheme; and establishment of the zone and creation of a suitable and efficient institutional framework for its management and day-to-day operation. Each of these factors are discussed briefly below, with a view to giving a picture of the related steps required before a free trade zone is actually established, and the interrelationship of these steps, which can promote or mar prospects of the successful development of a free trade zone.

Location near an airport

A free trade zone's location is the most important factor, and it should be decided very carefully. A free trade zone should be located only at a focal point that is well served by modern air and sea communication links and sophisticated telecommunication and postal links. This point should be on international air and sea routes. Being on an international air route is more important than the international sea route. Top executives travelling by air around the world have generally little time to go to an off-the-route place to see investment opportunities in a particular free trade zone. If the zone is adjacent to an airport, he will certainly consider it worthwhile to look at it during a halt of a few hours. The image remains in his mind when taking decisions later on investment policies.

Location near a seaport

It is often argued that the location of a free trade zone near a seaport helps bring down transport costs. This may be true in the case of heavy cargo. But if the export products are not very heavy, a seaport within a radius of even 150 miles would be quite suitable, provided it is a regular port of call by shipping companies serving the international routes. The people who make the decisions on foreign investmen more important than anything else, and a free trade zone should be on an internat route.

Nearness to suitable labour availability

Because of the improved means of communication now available, the location o export-oriented free trade zone need not now be tied closely to sources of raw ma electric power or, as already stated, to a seaport. The most important factor to next to accessibility to decision-makers, is the availability of reasonably intel and trained manpower in the area. It is a common experience in most countries th high-quality trained and intelligent labour is generally available in bigger citi with seaports and airports where trade, industry, power, communication and financ institutions, have already grown.

Regional planning and free trade zone

Two main arguments are generally offered in developing countries against the location of a free trade zone near bigger cities: (a) a free trade zone near a city will add to the industrial congestion and pollution problems; (b) land for up free trade zones in less industrialized parts of the country is available at c rates. The answer to these questions is very simple. Establishing export-orient industries, with an obligation to export 100 per cent of its produce, is a hard j An area which already has an industrial growth, with inherent infrastructure and availability, will enable the export industries in a free trade zone to develop t own industrial momentum at a much faster rate, generating additional employment a foreign exchange earnings, which would have otherwise remained unrealized. It is therefore, a question of making a choice of having an export-industries zone near concentration areas, and earning much needed foreign exchange, besides creating a tional job opportunities, or not having it at all. The question of paying a high price for acquiring land near a big city is of no significance compared to the re and objectives proposed to be achieved by the establishment of a successful free trade zone.

Safeguard against smuggling

It is also believed in most of the developing countries that it is easier to guard against smuggling by locating the zone in a remote area than in a concentra area. Such beliefs are generally unfounded and is a consequence of lack of knowl and experience in the field. A free trade zone or an export processing zone has work mainly on the basis of documentary control and less on physical control. As as a firm is able to show its export earnings as well as a clean record, by matching up its imports with the exports and inventory in hand, there are no reasons to suspect it unnecessarily. The development of the zone should, therefore, never be entrusted to the preventive services or customs officers as at present in most of the developing countries. The import-export traffic in the zone should only be regulated by the customs officers, but not the development of the zone. These two aspects need be kept distinctly separate.

Package of incentives

What package of incentives and facilities should be given, is one of the most important decisions to be taken at government level before a free trade zone or export processing zone should actually be set up. One factor which is to be kept uppermost in mind while taking these decisions is that no free zone can be developed successfully without attracting foreign capital and foreign technical know-how. Such is the situation so far in all the main successfully developed free industrial zones already mentioned. It should also be very clearly understood that the only thing a foreign investor is looking for is profit, and reasonable security of his capital through well-defined national government policies already announced. He can make profits only if he has relatively more advantageous tax exemptions, non-repayable grants and ready-made factory buildings to move into, besides the zone being available at a suitable location having adequate infrastructure and labour availability. If a zone does not offer these basic facilities and package of incentives on comparable advantageous terms, any amount of promotional efforts made will not produce the desired results. It has also to be accepted that there can seldom be identical packages of incentives in all the free trade zones or export processing zones in the world, because each country has to draw up a package by taking into consideration the geographical location of the country, and particularly the zone, the availability of labour and skills, raw materials, infrastructure and utilities in the area. A still more important factor is the industrial climate in the country, and particularly the region in which this free trade zone is to be established. Before deciding on the number of years for which tax holidays should be given, or fixing rates of low taxation and cash grants, the following main factors should be kept in view:

(a) What will be the transportation costs of the main identified raw materials to be used in the zone and the finished products to be exported from the zone. How do they compare with the free zones of other surrounding countries, or at least the few most successful free zones in different parts of the world?

(b) The industrial and export climate in the country, particularly from the point of view of foreign investment. Is foreign investment in the export-oriented industries in the country already fairly good?

(c) How do the labour costs and labour climate in the country compare with others?

(d) To what extent do the facilities envisaged to be provided in the zone in the form of infrastructure, developed plots of land, factory buildings and housing, reduce the initial investment cost of the foreign investor?

If the above four factors are very favourable, maybe no tax holidays are requ at all, as in Hong Kong, and only a low rate of taxation will make things attract: enough. If the position is otherwise, a heavy dose of incentives in the form of l period tax holidays and cash grants towards investment in fixed assets and the tr of workers can motivate foreign entrepreneurs. It should be emphasized once agair financial and fiscal incentives by themselves are not sufficient to induce new inc trial investments. Only a comprehensive scheme which contains various types of ir tives, facilities, a team of men responsible and dedicated to the project and, abc an attractive image of the project in the eyes of the industrial investors at home abroad, will be able to produce the desired results. If this over-all image of tl project, which depends largely on the totality of the incentive system and the zea dedication of the men on the spot to implement it, is missing, this is often founc be the main reason for the failure of an otherwise good project. Incentives offe in a complicated form, and inefficient conditions, cease to be incentives, and the pitfalls need be carefully avoided.

Selection of industries

By any standards of economic planning it would be unrealistic to base a progr of action on the belief that an industrially developing country, with its own reso of knowledge and technical know-how, can enter into the production of sophisticate goods, or even labour-intensive industries, on equal terms with industrially devel countries. As stated earlier, the share of manufactured products of the developir countries in the total trade of the world is still so low that it is posing a thre the industrial growth and capital markets of the developed countries regarding sus and keeping trade relations with the developing countries, which are lagging behir more and more in keeping up with the technological advancement and integrated trad systems of the developed countries, particularly in Europe. A careful analysis of world trade statistics, however, reveals one ray of hope for the developing count: and that is that, among the products traded, there are many final products, which or at least some parts and components of which could be more advantageously produc in the free trade zones of the developing countries, provided their comparative advantage of lower labour costs could be tactfully combined with lower taxation rates, a narrow tax structure, mild controls on the movement of capital, profits and goods, and a clear enunciation of foreign investment inducement laws. Industries committed to export 100 per cent of their products in a free trade zone have to be technically and commercially at par with the more advanced industries of the developed countries competing with them in foreign markets. A high degree of specialization is, therefore, necessary and, in this context, the selection of industries to be developed or expanded in a free trade zone assumes special importance.

There is no doubt that, limiting the industrial growth in a free trade zone to a preconceived positive list of industries, has its own shortcomings, as such a list may not be quite exhaustive. The other method generally applied is to prepare a negative list, indicating the industries, such as narcotics and dangerous drugs, which will not be allowed to be set up in the zone. This offers a wider scope to the investors to bring forward suitable proposals for starting new industries on their own. This, however, does not mean that the planning of a free trade zone should not include preparation beforehand of a list of the main categories of industries more suitable for development in the zone. The related facts of these industries, such as the sources of raw materials, the main markets where the end products are likely to be sold, the transport costs involved for the inward movement of raw materials and outward movement of end products, the availability of suitable labour in the areas, the infrastructure and inducements available for the inflow of foreign capital and technology need to be carefully studied, assessed and evaluated, and a project report should be prepared before embarking on the project itself. It would also be very useful to have such an assessment and evaluation study conducted by UNIDO experts so that a true picture indicating the full pros and cons of the situation would be available. This exercise would give an answer to the question often asked as to what extent a free trade zone may be a success.

International subcontracting

The industrially advanced countries in Europe recognized early in the 1930s that neighbours with equal industrial advancements were not only competitors for their products, but also provided a potential market for them. From this recognition emerged a new concept of international subcontracting, which has already become a routine practice by now among the industrially advanced countries. To make a product more competitive in quality and price, different parts and components of the same are now being produced at the most economic location in different countries. Such a practice is, however, still a rare occurrence between the developed and the developing countri The free trade zones in developing countries, because of their comparative advant have great scope in this field provided various prerequisites, such as technical how, capital security, suitable labour and supervisory staff, and so on, are alre available in the zone, and that growth has sufficient momentum to promise a bette picture in the future. Of all industries, engineering goods, particularly electr electronics, watches, cameras, and the transport and communication industries, off wider scope for international subcontracting. This programme has the basic advan of developing links with the international industries, which can promise unlimite scope for further expansion. UNIDO, in Vienna, has already done sizable and usef in this field, and many concrete specific offers are available with them from ind in the developed world seeking suitable partners in the developing countries, who provide them with their requisite components and parts at prices cheaper than the of their home products.

Combining the process of products selection with that of the development of national subcontracting facilities in the zone would, therefore, involve the foll steps and functions:

(a) Detailed screening of individual products selected, forecasting demand those in the developed markets. It must be ensured that the product categories selected are, in principle, attractive in quality and price to the markets where they are likely to be sold;

(b) Identification of the specific firms in the industrialized countries th are interested in subcontracting portions of their operations; suitabl domestic firms, capable of entering into foreign collaboration, should also be located beforehand;

(c) Detailed screening of the economic, legal and technical assistance required by potential foreign investors for developing wholly foreign-owned industries, or in partnership with domestic firms;

(d) Detailed screening of the technical training facilities required within the country, or abroad, to develop a competent core of technicians, and the maximum extent to which expenditure involved could be borne by the Government to keep the initial costs low for the incoming foreign investor.

After a thorough examination and evaluation of the afore-mentioned aspects ha been done by experts available within the country, and UNIDO experts who may be ca in to give an independent report, there is little chance that the results which wo be achieved in the zone would be in any way different from the original estimates.

Free trade zone legislation

It has been observed that some countries set up a free trade zone first, and thereafter, on the basis of success achieved, or experience gained, attempt to enact legislation on piece-meal basis to improve upon shortcomings. Construction of a free trade zone, without proper legislation to regulate it and adequate mechanism to promote industrial growth, is like putting the cart before the horse. Certain successful countries, like Ireland, had to pass as many as eight different Acts from 1947 onwards, when they passed their first Customs Free Airport Act in 1947, but at that time no prior experience was available to Ireland in this field, and they were actually the first to make experiments with the technique of a free trade zone. The situation has changed considerably over the last 25 years, and enough expertise is now available, both with the Shannon Free Airport Development Authority and the UNIDO secretariat in Vienna. Prior enactment of legislation before a free trade zone is offered to the public for setting up industries in it, is particularly necessary for the following reasons:

(a) It gives a clear picture of the government policies, rules and regulations for the zone to prospective foreign investors;

(b) It helps the administrators in the zone to carry out their functions more smoothly within the framework given by the legislation and this can avoid repeated references to the main ministry by the zone administration and the inordinate delays which such a process generally involves.

A common question is: What should be the main traits of well-drafted legislation for regulating a free trade zone? It is difficult to enumerate all points for a comprehensive legislation for all purposes, as in such matters each country has to draw up its own, keeping in view the specific circumstances and conditions obtaining in the country. It is felt, however, that, to begin with, free trade zone legislation should provide very clearly at least the following:

(a) A clear assurance from the national government against nationalization of any of the industries in the zone;

(b) A clear indication of the acts and practices which would be considered as offences on the part of the industries in the zone, along with any penalties to be imposed;

(c) A clear indication of the precise conditions and circumstances under which only the national government would withdraw the licence for continuing business activity in the zone by a foreign or domestic enterprise;

(d) A clear indication of the capital and income-tax laws and tax holidays available in the zone, besides restrictions, if any, on the inward and outward movement of capital, profits and assets of the foreign firms and foreign individuals;

(e) A statement of customs and excise privileges, indicating duty-free mover allowed of materials and goods into and out of the zone, involving trad with foreign countries;

(f) An obligation to export to foreign markets 100 per cent of the goods manufactured in the zone;

(g) A clear indication of the manner in which substandard goods, wastage an scraps would be disposed of, and any duties leviable thereon;

(h) Conditions and circumstances under which any percentage of the goods manufactured in the zone may be allowed to be diverted to the domestic market for internal consumption;

(i) The State's liability to commercial investors for political risks and w

(j) The State's liability to commercial investors in assuring an adequate s of water, power, communications and transportation services at reasonab rates;

(k) An indication of non-repayable cash grants admissible, if any, towards investment, overheads and training of workers;

(l) A clear policy regarding immigration and stay in the country of foreign nationals having investments in the zone, or employed therein;

(m) A clear indication of depreciation allowances, business registration and incorporation fees and stamp duty should also be given;

(n) The simplified procedures obtaining in the zone for the approval of inve applications, import and export licensing, foreign-exchange settlements, company registration, building construction licences and customs clearan should also be notified.

Establishment of a free trade zone

Technically, a "free trade zone" is an enclosed territory, under customs secu supervision, situated in or near an international seaport or airport, into which f merchandise and raw materials, not prohibited, may be brought and taken out withou being subject to customs and duties. The modern concept of a free trade zone or, appropriately, an "export processing zone" has now emerged on a slightly different basis due to the fact that an export processing zone is now being treated more as device for promoting the growth of 100 per cent export-oriented industries, backed foreign capital and know-how, in which raw materials and components can enter with being subject to customs duties. Complete or reasonable freedom should also be av able for the inflow of foreign capital and technology and the outflow of capital, fits and interest. The physical construction of a free trade zone is therefore by the simplest part of the whole task of developing it; the more important aspects evolving and enunciating government policies regulating the inflow of foreign capi and technology, the outflow of capital, profits and interest, rates of corporate a income taxation, identification of industries to be developed in the zone, locatin source points for international subcontracting and foreign collaboration, and prep estimates of the world supply and demand position for different categories of indu tries selected for the zone.

Institutional framework for the management and operation of the zone

Different experiments are being tried in different countries regarding the institutional framework for the management and operation of a zone. In Ireland, the Shannon free trade zone is managed by an autonomous body called the Shannon Free Airport Development Company. Besides managing the free trade zone, this autonomous body also manages Shannon Airport and the tourism work in the Shannon area. The management of this company hold the conviction that much of the success of the Shannon free trade zone is due to the autonomous status of the company, which is useful for undertaking bold and ambitious industrial promotion programmes, and also for smooth co-operation with the services and customs authorities; lack of such co-operation can have an adverse effect on the normal growth of a free trade zone.

In the Masan free trade zone management rests with a director who belongs to the Export Promotion Department of the Ministry of Commerce. All powers for approving investment applications, import-export licensing, foreign-exchange settlements, building construction licensing and so on, are vested in him, and he is expected to take a final decision on all applications within 48 hours. The zone is treated as a field office of the Export Promotion administration of the Ministry of Commerce, and different officers in the main ministry are required to serve their 9 months' term in the field offices by rotation. There is customs security supervision of the zone but the zone administration keeps a constant watch that customs security checks do not impede commercial activity and growth of the zone, or spoil the image of the zone for visiting foreign investors and traders.

The foregoing observations highlight two points:

(a) It cannot be said that management of a zone by a purely autonomous organization, like SFADCO in Shannon, is the only possible institutional arrangement for the successful development of a free trade zone; the Masan free trade zone is an equally successful experiment, functioning quite efficiently under the direct management of government officers with promotional background drawn from the Ministry of Commerce;

(b) Entrusting a free trade zone to the management of a customs officer is now an obsolete method, particularly when the emphasis of the use of a free trade zone device has shifted from "entrepôt trade", involving the movement of foreign goods inward and outward, to the development of an industrial park with selected export industries based on modern technology and sound market forecasting.

Accordingly, if the free trade zone is merely a "customs privileges territory", with no industrial programme as such, perhaps entrusting the supervision of such a zone to a customs officer would be quite appropriate, because it is only the customs security problem with which he would be expected to deal. But if an export processing zone is envisaged in the wider context of an industrial park for developing more sophistica industries, which could be developed only with the support of foreign technology an capital, management of the zone would be concerned more with undertaking ambitious industrial promotion programmes directly related to international trading and inves trends. In such a situation, the customs security supervision of the zone becomes less important, as controls are reduced to documentary controls rather than physica restraints. In such circumstances, it would obviously be better to keep the over-a zone administration distinctly separate from the customs security functions.

CHAPTER VI

Techniques of promotion of a free trade zone

After the basic decisions have been taken regarding the location of the zone, - package of incentives, facilities to be offered, the selection of industries suitab for development, the enactment of zone legislation, and the creation of an institut framework for the management and operation of the zone, the next important question generally asked is how to speed up the growth of industries in the zone. If impleme in the correct manner the following steps could do this:

Make an inventory of the plus and minus points of the zone vis-a-vis other free zones and export processing zones in the region and reassess the situation to see whether some of these minus points could be removed. It is worthwhile examining on a year-to-year basis to what extent the free trade zone is a "saleable product" as regards any new developments in other free trade zones in the region. Below is a mathematical formula to test the prospects of success of a particular free trade zor Each of the standard facilities and incentives granted in various free trade zones i the world have been reduced to certain weighted average marks which total up to 1,0C Any free trade zone or export processing zone scoring above 60 per cent of these mar have brighter chances of success. Zones scoring less than 40 per cent of the marks are in a hopeless category and it would be worth while reviewing the whole scheme ag Zones scoring between 40 to 60 per cent of the marks could be called neither a failu nor a success. In table 2 are given the weighted average marks for each category of incentives and facilities offered in a zone; the authorities concerned could try th formula and draw their own conclusions. For the sake of illustration only, Shannon, Masan, Hong Kong and Kandla are compared by assigning suitable marks for facilities available[1].

1/ This exercise was devised by the author and should not in any way be constr to be a criticism of any particular zone.

Table 2

Weighted averages in relation to Shannon, Masan, Hong Kong and Kandla

Description of incentives/ facilities	Standard weighted average marks	Marks assigned to			
		Shannon	Masan	Hong Kong	Kandla
Ten marks for each year of tax holiday, subject to a maximum of 200 for 20 years. Tax holidays for less than five years earn no marks	200	150	50	200[a]	–
Cash grants towards investment costs. Above 50 per cent qualify for the full 100 marks. Below 20 per cent earn no marks	100	100	–	–	–
Controls on movement of capital, profits and interest	100	100	100	100	50[b]
Cash grants towards workers' training. Above 50 per cent qualify for the full 100 marks. Below 20 per cent earn no marks	100	100	–	–	–
Advance factory buildings availability	100	100	100	–	25[c]
Advance housing, medical and entertainment facilities availability at the zone premises	50	50	50	–	–
Location of the zone[d]	150	150	150	150	–
Relative advantage in labour costs, availability of requisite skilled labour and labour climate in the country	100	100	100	100	25[e]
Relative advantages in transport costs on incoming raw materials and outgoing finished products	50	50	50	50	–
Enactment of clear legislation and efficient functioning of zone administration	50	50	50	50	–
Total	1,000	950	650	650	100

a/ The low rate of taxation at 15 per cent and a narrow tax base in Hong Kong are considered lowest in the world and even better than tax holidays. So full marks have been allowed.

b/ Movement of capital, profits and interest is allowed subject to certain conditions. So only 50 per cent marks have been given.

c/ Only a few industrial sheds were constructed and offered to the industrialists. So only 25 per cent marks have been given.

d/ On international air and sea routes – 50 marks; good communications network – 50 marks; good industrial infrastructure in the area – 50 marks.

e/ Money wage rates are cheapest in India, but Kandla being situated in the remote developing part of the country, availability of skilled labour is limited. Therefore, only 25 marks have been given.

Make a cost-benefit analysis of the zone

In addition to the exercise suggested above, it is also necessary to correla the costs involved with estimates of the benefits expected from the zone. Briefl a zone is to be built up in nearly 200 to 300 acres of land, to accommodate about industrial units, which would create employment for nearly 50,000 workers, beside the export earnings, then it is all the more necessary that the State investment the zone should be at an appropriate level, which would speed up further the grow of the zone. Merely creating an enclosed territory, with an office block buildin and calling it a free trade zone would hardly be fair. As stated earlier, the Ir Government spent as much as £14,200,000 to develop the industrial and housing est in the Shannon free trade zone, which has given employment to about 7,500 workers Similarly, the Korean Government spent as much as £10,300,000 on the development the Masan free trade zone, where nearly 23,300 workers are employed today. The b that can accrue, both in terms of employment and foreign exchange earnings, with successful development of a free trade zone, are of such great importance that, e tually, they far outweigh any amount of initial investment involved. It is there necessary for the level of State investment for the development of the industrial and housing facilities in the zone premises to be equally attractive and impressi

Create the basic literature in many forms and colours to sell the zone abroad

In Hong Kong, the Trade Development Council takes the view that, while selli products abroad, Hong Kong should be sold more than anything else. It is really name of Hong Kong that is selling its products now. Once a particular image of a is built up, many other related problems are solved automatically. In Shannon mo than a dozen brochures and booklets explain from different angles the benefits av able in the Shannon free trade zone giving; all kinds of hypothetical calculatio are given, explaining the tax benefits, labour and transport cost benefits, and s The creation and circulation of such impressive literature can be extremely helpf in attracting new parties to the zone. A vigorous programme of publicity, direct mailing and advertising, particularly in countries from which investments are lik to flow, should be a part of the zone's management operations.

Zone operations to be constantly reviewed and evaluated

Among the measures adopted by the United Nations during its second Development Decade, first priority was accorded to the task of bringing about an improvement in international trade conditions. Special emphasis was laid on the diversification and expansion of exports of manufactures and semi-manufactures emanating from developing countries. Therefore, the developing countries can now obtain special assistance from United Nations agencies, such as UNIDO and the World Bank, where a lot of expertise in this field has already been built up; the Masan free trade zone has already benefited immensely from an evaluation study carried out by UNIDO experts.

Senior officers in the zone administration to be rotated

The continuation of one team of dedicated men on a particular project, over a long period of time, where they rise or fall with the project is one method of achieving good results. At least, this is the opinion of experts in the Shannon free trade zone, where this method has brought excellent results. The other method, tried at the Masan free trade zone, is to bring into the zone promising and willing officers from the Ministry of Commerce, usually at the time of their promotion, where their enthusiasm and zeal are given a fair trial for three to four years. Before this enthusiasm and zeal become stale, they are replaced by a fresh and promising batch from the Ministry. All officers, including the director of the zone, are thus deployed for three to four years' field service in the zone and this helps check any inefficiency.

Full care must be exercised to see that the officers have the proper background in export promotion and export production and that they are willing workers. It is also necessary to reward adequately officers achieving good results by hard work and sincere effort to serve as an incentive for others taking up positions in the zone later.

CHAPTER VII

Free trade zone scheme in India

Establishment of Kandla free trade zone

The free trade zone scheme started in India with the setting up of the Kandla trade zone in 1965. Kandla is situated in Gujarat State at the end of the Gulf of Kutch. The port of Kandla was developed as a major port on the western coast of Ir to compensate for the loss of the port of Karachi in 1947. It is a modern port wit deep-water cargo and oil jetties and facilities for modern cargo handling. The thinking in the country at that time was that mere customs privileges in the form o customs and excise duty exemptions would prove attractive enough for the successful development of a free trade zone in the country, and that the zone should be establ near a major seaport. Kandla, being the youngest of the Indian ports, had less con tion problems and plenty of open space for locating a free trade zone. The success the zone was taken for granted, and it was estimated that this zone would provide m needed employment opportunities in the region, which is a remote developing part of the country, and also lead to fuller utilization of the port facilities at Kandla where the communications network and other commercial infrastructure were yet to be developed. Government outlay for the construction of the zone was approved at abou Rs.10 million, that is, £500,000. This included developing an enclosed industrial estate in 130 hectares of land, comprising 185 plots of various sizes, 16 industria sheds, a railway-siding in the zone, an office building block with arrangements for supply of water and power, and other related facilities, such as underground sewers, storm water drains and so on.

Development of the Kandla free trade zone

During the last eight years of the existence of the Kandla free trade zone, onl about eighteen industrial u its, mostly small size, and owned by Indian nationals, started functioing in the zone; they manufactured stainless-steel wares, knitting machines, art-silk fabrics, plastics products, laminated jute fabrics, and so on, and achieved an annual export performance of nearly 10 million rupees in 1972. Soor they began to feel hardship because of lack of industrial infrastructure in the regi Kandla port did not become a regular port of call for seagoing ships due to lack of

This vicious circle of "no ships because of no cargo" and "no cargo because of no ships" had an adverse effect on industrial growth in the free trade zone, and the industries existing in the zone started using Bombay port instead of Kandla for their import and export cargo, which involved additional transport costs, thus making export production operations in the zone non-competitive. The basic prerequisite of a free trade zone being located on an international sea route was therefore lost to the Kandla free trade zone since the Kandla port failed to develop as a regular port of call for seagoing ships. No foreign investment has so far flowed into the Kandla free trade zone for the obvious reasons that the package of incentives offered, and the conditions obtaining in Kandla were not found by foreigners to be attractive enough, as compared to those available in Malaysia, Hong Kong and the Republic of Korea.

Establishment of Santa Cruz export processing zone

Another export processing zone, called the Santa Cruz electronics export processing zone, has recently been set up near the international airport of Bombay. This zone also carries the same package of incentives but holds much better promise because of its very favourable location. Bombay is on the international air and sea routes and the zone, being adjacent to the airport, is within easy access of international investors travelling from west to east, and vice versa. Bombay has an abundant availability of a large pool of skilled manpower and technical personnel at low cost, as well as a well-developed industrial infrastructure in the sea. Nearly fourteen firms have so far been approved (up to September 1973) for setting up industries in the zone out of which six have foreign equity participation ranging from 40 per cent to 55 per cent. This zone has already had a good start and more foreign investors are getting interested in having business ventures in this zone. This, by itself, is indicative enough that the location of the zone is something of prime importance and that, though the tax benefits, cash grants and other related facilities offered in many other free trade zones in the ECAFE region far outweigh those offered in the Santa Cruz export-processing zone, it still looks like a promising venture.

India's requirements and the free trade zone scheme

India, with a land area of about 3.27 million square kilometres, occupies a major part of the subcontinent of Southern Asia. It has a coastline of 3,530 miles on the Arabian Sea, the Indian Ocean and the Bay of Bengal, and a population of over 500 million, which contains very capable sections of society. The money wage rates of both skilled and unskilled workers in India are still among the lowest in the world, even in the ECAFE region, when compared with Hong Kong, the Republic of Korea, Malaysia and so on India has already made rapid strides in industrialization and its internal transportation network, made up of nearly 60,000 km of railway and 300,000 km of surfaced roads is already one of the biggest in the world. A country like India, with so many important points of strength, is today ideally suited for the development of at least four to five potentially successful free trade zones, provided that these points of streng are recognized and utilized. India's capacities are said to be strained because of the increasing needs of the country, due to an expanding population and a developing industrial sector. The free trade zone scheme, if appropriately implemented, is an answer to the present strains of the Indian economy as, besides other things, it can generate a vast employment potential and foreign-exchange earnings, which are the prime needs of the country.

Proposals for the successful development of free zones in India

Below are a few recommendations which, if implemented, could go a long way towar achieving successful trade zones in India:

Suitable location of zones

India has the strategic advantage of being situated half way between Europe and the Far East and has some very well developed seaports and airports, which are on inte national routes and are fairly well known in the world. Accordingly, these seaports and airports offer excellent locations for developing free trade zones. Keeping in view the size of the country and its population, India has the potential of developing at least 4 or 5 free trade zones near the bigger cities of Bombay, Calcutta, Cochin, Goa and Madras. Among them, Bombay and Calcutta, which are on international sea and air routes, are ideally suitable for the purpose. After these zones were developed and some experience gained, more could be started later. Both Bombay and Calcutta have a well developed industrial infrastructure already and can supply a large pool of skilled manpower and trained personnel at perhaps the lowest money wage rates in the world.

Package of incentives

Tax exemptions

Keeping in view the opportunities available in other free industrial zones in the world, and in the ECAFE region in particular, a bigger package of incentives should be offered in India. This package should include the following to achieve the desired objectives:

(a) A complete tax exemption to be granted on profits generated by exports for 15 years plus 50 per cent relief for the next 10 years, up to 1999. Capital profits and gains accruing within the zones should not be taxable. Trading losses should be allowed to be carried forward for 10 years;

(b) Salaries and interest accruing in the zone to foreigners should also be exempt from taxes for the first 10 years and a 50 per cent reduction should be available during the next 10 years;

(c) No tax should be applied on incomes or profits arising abroad when remitted to the free trade zones;

(d) All foreigners and Indians living abroad should be allowed to maintain their own foreign-exchange accounts within the zones and there should be no control on the payment of funds from the zones to foreign countries. For this purpose the Reserve Bank of India should open a branch in the zone;

(e) The remittance overseas of all profits and dividends by foreign investors should be guaranteed from the first year of business operation. The remittance overseas of principal capital by foreign investors should also be guaranteed after 3 years of business operation;

(f) The resident Indians functioning in the zones should also be allowed to retain 5 per cent of their net foreign-exchange earnings in separate foreign exchange accounts, with full freedom to import any product or service into the zone against these funds for export production purposes;

(g) All foreigners, Indians living overseas and resident Indians should be given complete freedom to import any items, materials or services into the zone required for export production against foreign exchange provided from their own resources. Where a firm is unable to provide foreign exchange from its own resources, the existing practice of granting advance licences equal to their first 12 months' requirements of raw materials, to be replenished later according to the actual import content in the products exported, besides licences for the import of capital goods subject to indigenous availability, scrutiny, and so on could be continued to be followed;

(h) Liberal deductions could be allowed in respect of depreciation of fixed assets in calculating profits for income tax purposes. In this connexion, an accelerated depreciation allowance of 25 per cent per annum, admissible to all industries in the zone could be given;

(i) Agreements for the avoidance of double taxation should also be concluded with some of the main developed countries to facilitate the inflow of private foreign capital into the free trade zones in India. In the present circumstances, there are good chances of private foreign capital flowing into Indian free trade zones from France, the Federal Republic of Germany, Holland, Hong Kong, Japan, Sweden, Switzerland, the United Kingdom and the United States. Such agreements can make things doubly attractive for private capital in these countries looking for suitable opportunities elsewhere.

Cash grants

(a) All foreign-invested industries in the zone in which the import of plant and machinery, raw materials, and so on were financed against foreign-exchange resources of their own, should be eligible for non-repayable cash grants of up to 60 per cent of the total investment in fixed assets installed in the zone. The actual percentage of assistance could, however, be worked out on the merits of each case, keeping in view the net foreign-exchange earnings involved and the employment potential created;

(b) All factories in the zone could be granted research and development grants of up to 100 per cent of the cost incurred, depending upon the merits of each case;

(c) All factories in the zone could be granted financial assistance to the extent of 100 per cent of the cost of training workers and supervisors in India and abroad in the initial period of the setting up of a new factory.

Factory buildings

(a) All foreign-invested firms who finance the import of their plant, machinery and raw materials against their own foreign-exchange resources should be assured of built factory buildings of the requisite size being made available by the zone administration at concessional rentals. In cases where built factory buildings are not available in advance, and the zone's administration is not in a position to construct one for the firm within a period of six to eight months, the zone administration should grant a loan of up to 90 per cent of the costs involved at concessional rates of interest of 4 per cent, both capital and interest being repayable in 15 equal annual instalments. Detailed terms and conditions of this provision should be worked out and offered along with the other package of incentives and facilities available in the zone;

(b) As part of the development of a free trade zone, at least 100 apartments for foreigners and about 1,000 further apartments for workers should be constructed by the Government outside the zone at first, together with the provision for necessary medical, shopping and recreation facilities.

Project reports

Detailed project reports should be prepared on the product selection for each zone and on the subcontracting facilities to be developed in the zone, keeping in view the international industrial and trading trends.

Legislation

A comprehensive free trade zone legislation should be enacted without delay and before any further free trade zones or expanded processing zone is set up, incorporating all the points indicated in para.5, chapter V, and particularly giving an assurance against the nationalization of export industries, both Indian-owned and foreign-owned.

Institutional framework

Keeping in view the nature of work involved, the institutional framework for a free trade zone should be such that the customs security supervision functions are kept distinctly separate from the over-all zone administration. The directors and deputy directors of the zone should generally be drawn from the export promotion cadre of the Ministry of Commerce, and have at least five years' experience in export promotion work; these should generally be persons with proven ability and willingness to work in the zone.

Sale in India

All foreign-invested units in the zone who finance their import of plant, machinery and raw materials against their own resources of foreign exchange should be allowed to sell 10 per cent of their total production in India, on payment of a flat rate of 150 per cent duty. This should be allowed only after a unit has gone into full swing and has achieved its export target to the full, as given in the original investment application, which should not be earlier than three years from the date of sending their first export consignment, and on achieving a target of Rs.20 million of net foreign-exchange earnings in the previous year.

Export from India to the zone

All goods and materials supplied from India to the zone and paid for in foreign exchange should be treated as exports from India and should qualify for all the export benefits available in the country. Materials supplied from the country but not paid for in foreign exchange should qualify for export benefits only after these have finally been exported from the zone to foreign countries for which suitable certification should be given by the zone administration.

Display of duties leviable on sale of goods to India

The zone administration should display every day outside its office a separate classification for each of the products and components manufactured or stored in the zone and the rate of duties leviable on each for supply to India.

Disposal of scrap, wastage and substandard goods

Goods and materials which an industrial unit in the zone is unable to export to foreign markets should be allowed to surrender them within prespecified percentages to the zone administration, who may auction the same to the public on the first Wednesday of every month and pay 40 per cent of the price realized to the firm, while the other 60 per cent could be deemed to be government duty levied as revenue to the zone administration. Goods and materials which fail to sell in two consecutive auctions could be destroyed by the zone administration, for which no compensation would be payable to the firms. No auction charges or storage fees should be levied by the zone administration on these goods.

Estimates of financial outlay involved

Any proposal made should also indicate in precise terms the financial outlays involved and estimates of the benefits which would accrue from this expenditure. Examples are given below, very briefly, of estimates of the costs involved for developing a free trade zone at Sheva Neva, near Bombay, or near Dum Dum Airport, Calcutta:

	Rupees 10 million
Suitable land at these places may be available on lease from the State Governments. But if no such land is available, outright purchase or acquisition may be attempted. A plot of land of about 500 acres would be enough, for which a provision of Rs.50 lakhs could be made	0.50
Development of industrial estate, including enclosure, providing water, power, underground sewers, water drains and so on, besides the office building	1.50
Provision for the construction of factory buildings or loans for this purpose. Each building may cost about Rs.4 to 5 lakhs. A provision may be made for 75 factory buildings in the first year and 50 buildings for each following year	4.00
A block of 100 apartments for foreigners	1.00
About 1,000 apartments for workers	1.00
Medical facilities, shopping and recreation centres	0.25
Total:	8.25
Cash grants	
Provision for non-repayable cash grants on fixed assets	5.00
Provision for research and development grants	1.00
Provision for grants for training of workers	2.00
Total:	8.00
Grand total:	Rs.162.5 million

It can thus be seen that the minimum outlay necessary to develop a modest but reasonable free trade zone in India would involve at least Rs.8 million, or £4 million. This is on the low side when compared to £10.3 million spent on the Mason free trade zone by the Korean Government or £17 million spent on the Shannon free trade zone by the Irish Government.

Still more important is the role of cash grants payable towards fixed overheads, the training of workers, and research and development. The total cost involved in one zone would therefore be around Rs.160 million and for two zones in Bombay and Calcutta around Rs.320 million. This would facilitate the setting up of about 200 industries in each zone, giving direct and indirect employment to about 50,000 workers, and generating annual export earnings of the order of at least Rs.1,000 million in each zone. With these objectives in view, the money spent on developing a free trade zone would by any measurement, stand out distinctly as the most profitable investment to be made compared to any other developmental expenditure incurred.

United Nations assistance

It can be observed from the list given in annex 1 that there are not many free trade zones in the developed part of the world, except the one in Ireland; the rest are more in the form of transit zones only. The export processing zones developed as industrial parks are therefore mostly in the developing countries only; they are experimenting with this device for accelerating their industrial growth, creating additional employment opportunity and earning much needed foreign exchange. The UNIDO secretariat in Vienna has elaborate programmes at present to assist developing countries in the fields of: (a) feasibility studies; (b) selection of industries; (c) recommending packages of incentives and privileges; (d) attracting suitable entrepreneurs from foreign countries; and (e) diagnosing the problems of existing zones for the suggestion of suitable remedies.

CHAPTER VIII

Conclusions and recommendations

In the light of all that has been stated in the foregoing chapters, some basic conclusions can be drawn and are given below for the benefit of those who are interested in the concept of free trade zones, their practical usages and their role in the overall export production drive in a country.

Built-in mechanism in the scheme

The construction of a free trade zone or an export processing zone is a relatively very simple matter. What is important is the built-in mechanism in the scheme, including the package of incentives and facilities offered for attracting industries into the country and into the zone. For this, special attention should be given to the proposals made in chapters V, VI and VII.

Foreign-owned industries and the free zone

A developing country with its own resources of knowledge and technical know-how can hardly enter into the production of sophisticated goods, or even labour intensive industries, on equal terms with industrially advanced countries. This technical know-how is generally available with foreign capital participation only. The industries in a free trade zone, which would have the capacity to compete at par in international markets would therefore be foreign-owned or foreign-collaboration industries only. There are rare chances of purely domestic-owned industries using indigenous knowledge and technical know-how making much headway in a free trade zone. To attract such foreign-invested industries, a special package of tax incentives and cash grants, as suggested in chapter VII, would be required.

Tax exemption - a principal weapon

The tax-exemption incentive is today the principal weapon in the hands of developing countries who have lagged behind in the industrial race against the developed countries. Tax exemption literally means no strain on the existing finances for the exchequer. The developed countries cannot afford to forego these taxes because they are already at saturation point or at problematic stages of industrial progress in which tax exemption could not bring any additional benefit. Compared to this, the developing countries need industrial growth, additional employment and foreign-exchange earnings, and by giving tax exemption, they forego what is not even available.

Cash grant - a powerful tool

Cash grant is another powerful tool for attracting much needed foreign investment into the free trade zone of a developing country. Nothing in this world is available free and each country has to purchase its economic development, additional foreign-exchange earnings and additional employment opportunities. Once going, momentum is gained. But before that, it is necessary to create attractive conditions so that industrial capital and know-how move from the economically congested and polluted developed world to breath fresh air, with new opportunities, in the developing countries.

Free trade zones - as a government-backed initiative

A free trade zone or an export processing zone must be visible to the world at large as being essentially one of government initiative, backed by the full force of government authority, with assurances and guarantees regarding the safety of investment against any moves of nationalization. The nature of government commitment must be permanent, in the form of legislative enactment, ensuring a climate in which export industries could develop.

Free zones and the centrally-planned economies

The tool of the free trade zones is essentially more suitable for developing countries. Many of these countries today are tilted towards centrally-planned economies, but every countr has to develop links with the international commodity markets and international capital markets to be able to export its goods. These links provide an opportunity to form bridges with the developed countries, who predominate in manufacturing and trading affairs and to have contacts with the trade centres of the world.

Many medium-sized firms instead of a few large ones

In the process of attracting foreign investment, it may be felt that a country's economic independence may be submerged by international financiers and multinational companies, but this is not so in the present age, and particularly if care is exercised to encourage many medium-sized foreign firms from many countries to participate in industrial development for export purposes only.

Arguments against sale of goods within a country

It is often argued that even a small percentage of goods produced in the zone, if allowed for sale within the country, can create economic distortions and may wipe out some domestic industries. A domestic industry flourishing under tariff protections within a country which offers a vast lucrative market, as India, generally grows up as a highly inefficient monopoly concern producing low-quality products. This process helps neither the people nor the country in the long run, but helps only a few persons who are in entrenched positions owning these monopolies. Allowing a small percentage of high-quality products from the zone into the internal market would give such existing industry a very small dose of competition, sufficient enough to wake it up from its lethargy and create an urge to produce goods comparable in quality and price to the goods coming from the zone. If some industries still tend to die, then it is worth while allowing them to die and replacing them by export-oriented industries in the zone, exporting nearly 90 per cent of their production to foreign markets. In this process, a country can transform its protection-sheltered industries into export-oriented industries.

Need for development of good industrial climate in the country

The industrial climate within the country often has a direct influence on the industrial growth within a free trade zone. It is therefore essential that the same package of incentives is also offered for setting up export industries under customs security supervision anywhere else in the country outside the zone, except that the special facilities of complete freedom to import goods, or customs duty privileges, and built factory buildings available in the zone, would not be available outside the zone. This would help the growth of the export industrial base in the country, eventually manned and managed by local nationals only. This is what has been done in Ireland and in the Republic of Korea. There is, therefore, no reason why it should not produce equally good results in any other country, and particularly in India.

Import duties on replenishment licences for export industries

One practice generally followed in developing countries, and particularly in India, is to levy import duties on the import of raw materials. Manufactured products exported are eligible for a refund of import duties levied on the content of the imported materials used. Every time an exporter or a trader imports raw materials he pays import duty, and on each consignment of exports of manufactured products he collects a refund; this causes a lot of work in collecting drawback refunds, besides the financial burden of locking up the funds. This huge exercise helps neither the country nor the exporters, except that the preventives officers go on increasing in number. Once a registered exporter has effected exports in which duty-paid materials were used, it would be better to give him replenishment licences, equal to the import content in the exported goods, on a duty-free basis, than to give him drawback refunds on his exports. Materials imported subsequently over and above the value of the replenishment licences due, would only be subject to duty. In brief, there should be no duty levied on replenishment licences issued on goods already exported while duty may be levied only on initial or advance licences.

Also, all industries in regular production, and exporting more than 60 per cent of their production to foreign markets, should be allowed the special facility of the duty-free import of raw materials against a bond for export within a specified period of 18 months. In defaulting cases, only duty may be realized on the strength of the bond. Such measures can go a long way towards building up the image of the facilities available in the country for attracting more export industries from abroad. There is a need for developing such facilities in India.

Registration of exporters and investigation of commercial complaints from abroad

The image in foreign markets of the export industries inside a country has a direct reflection on the export industries in its free trade zones. It is, therefore, essential to tighten up discipline among the existing export industries in the country, particularly in matters of the registration of exporters and the investigation of commercial complaints received from abroad. In the Republic of Korea there is a system for allowing registration only to those who have minimum bank deposits or letters of credit for a minimum value of $US10,000. In both the Republic of Korea and Hong Kong work relating to the registration of all exporters and investigation of all commercial complaints received from abroad are kept restricted with the government officers in the Ministry of Commerce and Industry. A high degree of importance is attached to this work and no interference is allowed from any association of industries or any such other agencies, as it is believed that non-official organizations generally composed of conflicting factions, are not suitable for such regulatory functions. It is felt that there is a great deal of merit in this system and such regulatory functions should be kept confined with the government officers in the Department of Export Promotion to give a good image abroad.

Exporters' associations and promotional work

A network of exporters' associations or export councils for broad categories of industries is necessary to organize the export promotional machinery in a country. These councils or associations should play an active role in the promotion of exports from industries outside the zone and from the zone export industries as well. As in Hong Kong and the Republic of Korea, all industries should be obliged, under government order, to contribute 0.5 per cent of the value of their commercial imports towards a fund for financing the promotional activities of these export councils or associations.

These organizations should, however, play strictly a promotional role only, which may be evaluated yearly in terms of the results achieved in relation to promotional activities undertaken. In no case should these councils or associations be entrusted with "regulatory functions", such as the registration of exporters and investigation of commercial complaints from abroad, as these draw heavily on their limited time and resources with the result that less and less attention is paid gradually to the promotional functions for which they were mainly created.

Tax benefits may attract multinational organizations to move head offices

The creation of free trade zones and a proper climate for export industries in the country, backed by tax holidays and cash grants, can unfold new vistas of long-range benefits hitherto untapped in a country. One such benefit can be in the shape of big foreign companies moving their head offices to such countries to take advantage of tax benefits, avoidance of double taxation and the resultant payment of higher dividends to their shareholders. This has happened to some extent in Hong Kong, and some big companies in the Federal Republic of Germany and the United Kingdom are now understood to be examining these aspects in relation to Ireland. There are, however, good prospects of such things happening in India, provided tax benefits and grants are offered in a bold way. Further studies in this field by institutions like the Indian Institute of Foreign Trade, can yield useful results.

Code of conduct for free trade zones

Free trade zones or export processing zones are going to be increasingly popular in the developing countries in the next ten years. Almost each developing country will be in this race, but the success of each zone will depend on the combined effect of various factors, such as location, package of incentives, the political links with the countries from whence the foreign investment can flow, and the confidence those countries can generate about the security of foreign capital and profits arising therefrom. Some countries may not be able to offer all these factors, and may try to offer a still higher package of incentives to make things attractive enough. It is therefore necessary for UNIDO to consider evolving, in good time, a code of conduct for these free zones to ensure a fair dealing among themselves.

Need for informative literature

There is not enough literature available yet on the experiments of the different countries in the field of free zones or discussion of the merits and demerits of the various measures adopted in different countries for the successful development of the free zones. There is literature available in the UNIDO secretariat at Vienna, but more is needed. Any training programmes that may be organized by UNIDO in the field of free zones would need more literature on the subject. This report may perhaps partly meet this requirement in respect of the zones described, but UNIDO may consider having similar study reports prepared for other free zones in the world and making them available in a comprehensive form to the developing countries. Experts with mature understanding in developing countries where free zones have not been a great success should also be invited to participate in any seminars or training workshops to be organized by UNIDO, so that they can share with others experiences gained from failures thus provoking new avenues of thinking on the subject.

Annex 1

WORLD-WIDE FREE TRADE ZONES

Country	Location	Type of facility	Year founded
EUROPE			
Austria	Graz	Free trade zone	1955
	Linz	" "	1955
	Vienna	" "	1955
Denmark	Copenhagen	" "	1960
Finland	Helsinki	" "	1965
	Turku	" "	1965
	Hango	" "	1961
Federal Republic of Germany	Bremen	" "	1883
	Hambourg	" "	1888
Gibraltar	Gibraltar	" "	1704
Greece	Piraeus	" "	1950
	Thessaloniki (Salonika)	" "	1925
Ireland	Shannon	" "	1947
Italy	Trieste	" "	1955
Spain	Barcelona	" "	1929
Sweden	Gothenburg	" "	1935
	Stockholm	" "	1935
Switzerland	Basel	Free port	1904
Yugoslavia	Belgrade	Free trade zone	1964
	Koper	" "	1954
	Rijeka	" "	1964
MIDDLE EAST			
Bahrain	Mina Sulman	Free trade zone	1958
Lebanon	Beirut	" "	1948
	Tripoli (Tarabulus)	" "	1948
AFRICA			
Liberia	Monrovia West Africa	Free trade zone	1948
Libyan Arab Republic	Tripoli	" "	1964
Morocco	Tangier	" "	1959

(cont'd)

WORLD-WIDE FREE TRADE ZONES (cont'd)

Country	Location	Type of facility	Year founded
FAR EAST			
Hong Kong	Hong Kong	Free port	1842
India	Kandla	Free trade zone	1965
	Santa Cruz	Export processing zone	1974
Malaysia	Penang Island	Free port	1948
Ryukyu Islands	Naha	Free trade zone	1960
Singapore	Port of Singapore	Free port	1819
Thailand	Bangkok	Transit zone	1782
Republic of Korea	Masan	Free export zone	1971
	Iri	" "	1974
NORTH AMERICA			
United States of America	Honolulu, Hawaii	Free trade zone	1965
	Toledo, Ohio	" "	1960
	New Orleans, La.	" "	1946
	Kansas City, Mo.	Foreign trade zone	1973
SOUTH AMERICA			
Bahama Islands	Freeport	Free trade zone	1955
Bermuda	Freeport (Ireland Island)	" "	1956
Brazil	Manaus	Free port	1957
Chile	Arica	Northern zone free perimeter	1953
Colombia	Barranquilla (Caribbean)	Free trade zone	1964
	Palmaseca (near Cali)	" "	1973
Mexico	Coatzacoalcos	" "	1946
Netherlands Antilles	Aruba	" "	1956
	Curaçao	" "	1956
Panama	Colon	" "	1948
Puerto Rico	Mayaguez	" "	1961
Uruguay	Colonia	" "	1949
	Nuava Palmira	" "	1949

Annex 2

SHANNON FREE TRADE ZONE (IRELAND)

Table 1. Basic statistics

	Industrial estate	Airport	Town	Construction	Total
Employment 1973	4551	2060	597	516	7724
(1972)	(4378)	(2123)	(545)	(479)	(7525)
Wage Bill (estimate) 1973	£5 million		£4 million		£9 million
		million pounds sterling			
Investment (estimate) 1973	28.7	12.5	12.1	-	53.3
State	14.2	11.0	9.8	-	35.0
Private	14.5	1.5	2.3	-	18.3

All facts and figures, unless otherwise stated, refer to calendar years. Estimated figures used are those of the Shannon Free Airport Development Company's research and Planning Division.

SHANNON FREE TRADE ZONE (IRELAND)

Table 2. Capital expenditure and cash grants

1960-1973 (Year end of March)

(Pounds sterling)

Year	Industrial	Housing	Grants
1960	283,000	140,000	56,354
1961	606,000	312,000	138,496
1962	397,000	333,000	167,396
1963	748,000	326,000	111,482
1964	626,000	378,000	155,868
1965	673,000	352,000	207,795
1966	707,000	263,000	261,620
1967	138,000	477,000	199,721
1968	574,000	781,000	297,343
1969	613,000	1,025,000	396,632
1970	582,000	958,000	498,248
1971	763,000	1,161,000	497,549
1972	963,000	1,230,000	217,549
1973	1,080,000	1,040,000	240,926
	8,753,000	8,650,000	3,446,529
Site adjustments	-90,000	+80,000	-
Total	£8,673,000	£8,730,000	£3,446,529

Estimated private investment 1960-1973:

Foreign investment	13.0 million
Irish investment	1.1 million
Total	£14.1 million

Table 3. Shannon Industrial Estate Trade 1964-1973

(million pounds sterling)

Year	Exports				Imports			
at 31 March	Air	Surface	Total	Change %	Air	Surface	Total	Change %
1964	11.0	2.9	13.9	-	8.3	3.2	11.5	-
1965	18.8	3.9	22.7	+63.3	12.4	3.6	16.0	+39.1
1966	27.1	4.6	31.7	+39.6	19.7	4.5	24.2	+51.2
1967	27.6	5.0	32.6	+ 2.8	17.1	5.4	22.5	- 7.0
1968	30.6	4.6	35.2	+ 8.0	15.3	4.9	20.2	-10.2
1969	32.9	5.0	37.9	+ 7.7	17.9	6.3	24.2	+19.8
1970	35.0	4.7	39.7	+ 4.7	18.2	5.1	23.3	- 3.7
1971	30.1	3.9	34.0	-14.4	14.3	5.0	19.3	-17.2
1972	32.3	4.0	36.3	+ 6.8	15.7	5.0	20.7	- 7.3
1973	-	-	47.4	+30.6	-	-	23.2	12.1
Total:			291.4				205.1	

From 1971 onwards no breakdown of trade between air and surface is available. The estimates used are those of the SFAD Company.

Annex 3

MASAN FREE EXPORT ZONE (REPUBLIC OF KOREA)

Table 1. Government investment by sectors

(million Won)

Items	1970-1973	1974	1975 (Plan)	Total
Construction of industrial estate	2,831	67		
Water facilities	195	32	1,946	6,772
Port construction	841	187		
Dredging for wharf site	464	209		
Public facilities	403	-	-	
Standard factory buildings	1,793	-	-	
Welfare facilities	315	-	-	2,886
Incidental public facilities and administrative expenditure for construction	223	82	50	
Total	7,065	577	1,996	9,638

MASAN FREE EXPORT ZONE (REPUBLIC OF KOREA)

Table 2. Foreign investments and firms by country

(As of end of April 1974)

(thousands United States dollars)

Year	Italy		Japan		United States		Total	
	Firms	Amount	Firms	Amount	Firms	Amount	Firms	Amount
1971	-	-	20	4,689	2	200	22	4,869
1972	1	520	61	31,592	8	2,806	70	34,918
1973	1	738	105	75,658	9	2,379	115	78,775
1974	1	738	105	89,455	7	1,790	113	82,983

Note: Amounts indicate net foreign investment (excluding Korean joint venture portion); yearly figures are the cumulative total; investment from Korean sources: $US7 million.

MASAN FREE EXPORT ZONE (REPUBLIC OF KOREA)

Table 3. Exports and Employment

Year	Exports (thousand dollars)	Employment (persons)	Operating factories
1971	857	1,446	6
1972	9,739	7,106	26
1973	70,374	21,240	71
1974 (January-April)	46,321	23,334	81
Target 1974-1975	$US200 million		

MASAN FREE EXPORT ZONE (REPUBLIC OF KOREA)

Table 4. Percentage share of different industries in the zone

Industry	Number of firms	Percentage
Electronics	27	23.8
Machinery	41	36.2
Chemicals	15	13.2
Toys and handicrafts	10	8.9
Opticals	8	7.1
Textiles, garments	6	5.3
Processed foods and seafoods	1	0.9
Others	5	4.5
	113	100.0

Annex 4

HONG KONG FREE PORT

Table 1. Number of tourists visiting Hong Kong

Year	Persons
1950	n.a.
1955	n.a.
1960	163,661
1965	406,508
1970	927,256
1973	1,291,950

HONG KONG FREE PORT

Table 2. Foreign investment in the Hong Kong manufacturing industry
(as at 30 September 1973)

Country source	Investment (HK$ million)	Percentage	Establishments (No.)
Australia	55.0	4.7	13
Japan	305.9	26.1	65
Netherlands	20.1	1.7	6
Philippines	13.0	1.1	8
Singapore	116.9	10.0	11
Switzerland	10.9	0.9	9
United Kingdom	117.9	10.1	25
United States	479.5	41.0	120
Others	36.8	3.2 *	33
(Indonesia)	(2.57)		(4)
Total	1,156.0		290

* not clear on original

HONG KONG FREE PORT

Table 3. Foreign trade of Hong Kong

(in HK$)

Year	Imports	Exports[a]	Re-exports[a]
1950	3,787.66	3,715.55	
1955	3,718.92	2,533.99	
1960	5,863.69	2,867.25	1,070.46
1965	8,964.83	5,026.80	1,502.76
1970	17,606.71	12,346.50	2,891.57
1973	29,004.60	19,474.35	6,525.01

a/ Exports and re-exports trade figures were not separately classified until 1959.

HONG KONG FREE PORT

Table 4. Export percentage in industrial production

ISIC Code	Industry	Exports in 1970 (thousands HK$)	Exports as percentage of total production
11-12	Food	198,878	30.5
13	Beverages	1,960	1.2
14	Tobacco	64,765	26.9
21; 25-29	Textiles	1,518,812	45.3
22	Wearing apparel, except footwear	4,633,345	88.3
23	Leather and leather products	27,869	50.4
24	Footwear, except rubber, plastic and wooden	92,456	71.7
31	Wood and cork products, except furniture	117,468	49.3
32	Furniture and fixtures, except metal	54,919	38.9
41	Paper and paper products	19,498	7.4
42	Printing, publishing and allied industries	61,926	15.1
51-52	Chemicals and chemical products	111,412	43.6
55	Rubber products	152,343	82.6
56	Plastic products	1,434,109	81.4
6	Non-metallic mineral products, except products of petroleum and coal	28,934	24.4
7	Basic metal	56,822	16.9
81	Fabricated metal products, except machinery and equipment	658,380	60.7
82	Machinery, except electrical	41,740	22.9
83	Electrical machinery, apparatus, appliances and supplies	1,264,856	83.6
84	Transport equipment	103,270	25.9
85	Professional equipment, photographic and optical goods	142,963	80.0
9	Other industries	936,093	82.1
	All industry	11,722,818	65.0