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*for a sustainable future*

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## INTRODUCTION

Industrial free zones have been created by many developing countries as an incentive to promote export-oriented industries. In the region of the Caribbean, Central and South America, many forms of "free zones" exist or are planned. The use of this relatively new tool of industrial development, however, has brought with it a number of problems. As part of its programme to assist those zones that create new employment by facilitating investment in export manufacturing, the United Nations Industrial Development Organization (UNIDO) organized, jointly with the Free Zone of Barranquilla, a Regional Expert Group Meeting on Industrial Free Zones, which was held at Barranquilla, Colombia, from 5 to 11 October 1974.

The purpose of the Meeting was to discuss the economic viability of expanding industrial free zones in developing countries in the region.

More specifically, its objectives were:

- (a) To define industrial free zones as export manufacturing zones distinct from general industrial import and export zones;
- (b) To review problems arising from the proliferation of free zones, particularly in the Caribbean, Central and South America;
- (c) To review the performance and the effects of industrial free-zone establishment on general growth of exports and on foreign investment in developing countries.

## RECOMMENDATIONS

The Meeting considered in plenary session the conclusions of the two working groups into which the participants had been divided and recommended that:

1. UNIDO should in future use the phrase "export manufacturing zone" rather than "industrial free zone";

2. Under the auspices of UNIDO some form of free zone association should be set up, with the following objectives:

To promote communication between zone planners

To produce and circulate relevant statistical information

To exchange methods of evaluating investors and information on them

To arrange training and exchange visits of staff or potential staff

3. Trade unions should be permitted to operate within zones so that wage levels can reach their natural economic levels without restraints;

4. Legislation should prevent zone manufacturers from selling on domestic markets, should encourage 100 per cent export of production, and allow local sales only as an exception, and after full payment of all duties and taxes. Legislation should also control, where necessary, the export of the products of free-zone investors to developing countries in the region, particularly where common markets exist.

## I. ORGANIZATION OF THE MEETING

The Meeting was attended by 10 participants from developing countries or territories, 5 international consultants, 34 observers from developing countries, 2 observers from developed countries, 3 representatives of UNIDO and 1 observer from the United Nations Conference on Trade and Development (UNCTAD).

Countries or territories sending participants were: Barbados, Belize, Guatemala, Haiti, Jamaica, Mexico, Nicaragua, Trinidad and Tobago, Uruguay and Venezuela. Four of these countries also sent additional representatives at their own expense.

Countries that sent observers were: Chile, Dominican Republic, Colombia, Mexico, Nicaragua, Mauritius, Panama and Venezuela. Ten countries sent observers at their own expense, which indicates the degree of interest shown in the subjects under discussion.

Staff of the Barranquilla Free Zone and staff from planning agencies in Colombia also attended.

The Meeting was opened by Jorge Ramirez Ocampo, the Minister of Development of Colombia.

Five speakers, each holding a leading position in the management of a free zone, prepared papers for the Meeting. These papers are listed in annex II.

Two working groups were formed to facilitate discussion and to draft recommendations on the main subjects. The working groups presented their conclusions individually to a plenary session of the Meeting, which then discussed and adopted the formal recommendations.

Visits were made to several manufacturers in the Barranquilla Zone to familiarize participants with the types of industry that invested in such a zone, and their methods, needs and attitudes.

Spanish and English were the official working languages of the Meeting.

## II. DISCUSSION IN WORKING GROUP ONE

### Nomenclature

One of the tasks of Working Group One was to define the role of an industrial free zone as opposed to a purely commercial zone. The Working Group examined, therefore, the reasons why UNIDO had been using the phrase "industrial free zones".

It was pointed out that this term did not exclude import-oriented zones, since these were also industrial, in that they stored or processed imported products. Those goods were then released from bonded store after payment of import duty and sold on the domestic market. Some planners wished to include commercial operations in a free zone. In practice, that would mean providing for warehousing, storage prepacking and sorting of goods in transit. Almost always such an arrangement would involve more imports than exports, and thus, since it would not create much employment either, was not suitable for most developing countries.

Another practice that reduced the value of an export free zone was that of permitting some zone production to be sold on the domestic market. Fortunately, the products of most zones were not marketable locally (e.g. electronic components, high-priced fashion garments or optical goods). It was felt that the aim of an industrial zone was to export, if possible, 100 per cent of production. All raw materials or components imported duty-free should be exported.

It was felt, therefore, that the word "export" should be included in whatever phrase was adopted to describe a zone as well as the word "manufacturing", which would emphasize the employment aspect. The word "free" could be omitted, since duty-free import of raw materials or components was generally understood, and "free" was common to commercial zones and even to storage/trans-shipment zones in many developed countries.

Thus, a better term for an "industrial free zone" would be "export manufacturing free zone" or "export processing zone". However, it was recognized that some zones had names such as "export processing zone" or "free zone" written into their legislation. It was agreed that no attempt should be made to change established names; the intention was rather to provide guidance to developing countries in future.

#### Proliferation of free zones

The Working Group considered the problems that were arising because several developing countries were planning to establish more than one free zone simultaneously. It was pointed out that the increasing wage differentials between developed and developing countries would encourage many developing countries to establish such zones. Such proliferation was considered unwise and uneconomic, for it would place too great a demand on resources; funds for setting up more than one efficient zone would rarely be available. The necessary management staff would usually not be available for staffing more than one zone. It was recognized, however, that regional proliferation was a question of national policy, a matter for each sovereign State to decide, and a limitation of free zones in a region was not enforceable.

Therefore, the Working Group considered that some form of export manufacturing zone association should be set up to harmonize objectives and minimize possible competition. It would result in a transfer of technology between the longer established zones and the newer ones. Such an association could also carry on very effective public relations by mounting suitable display panels showing zone locations, zone products, terms etc. in selected sites, such as world trade centres and large airports. It was predicted that it would take up to a year to create such an association. UNIDO could co-ordinate efforts to set up such an association, in conjunction with existing free zones.

### III. DISCUSSION IN WORKING GROUP TWO

#### Customs-policy aspects of free-zone operations in relation to regional common markets

The Working Group considered the anxieties expressed concerning the effect of free zones on such regional groupings as the East Caribbean Common Market (ECCM) and the Central American Common Market (CACM). As free-zone investors were unlikely to be exporting to the very small markets in the region, the likelihood that such exports would damage non-free-zone producers was considered small. Most free-zone investors established themselves to supply existing markets, if not their own companies. Protection against leakages to the domestic market could be provided by legislation.

In the Andean Group, free-zone products would not receive preferential treatment, which was one safeguard against the possibility that free-zone products would be sold in the regions, since the tariffs would make that unprofitable.

Customs control would be simplified and possible problems minimized if all production of export manufacturing zones were exported to third countries, as is normal.

It was noted that products from export-processing zones were entitled to preferences under the Generalized System of Preferences, provided that the product originated largely in the preference-receiving country.

#### Effects of proliferation of free zones on regional common markets

Under the leadership of the UNCTAD representative, the Working Group examined the question of proliferation from the point of view of trade and customs policy.

The Group came to the conclusion that:

(a) The fear of customs difficulties and possible distortions of intra-trade within regional groupings, which might result from the establishment of

export-manufacturing zones, would in most cases seem to be capable of resolution. Very largely, exports from free zones were aimed, not at small local markets, at the larger markets of developed countries;

(b) Under the Generalized System of Preferences, entitlement to such preferential treatment was unaffected by production inside a free zone, i.e. such exported products were normally treated as if they were processed in the preference-receiving country in which the zone was established;

(c) The larger developed country markets allowed imports of certain labour-intensive products, such as electronic components, with payment of tariff on added value only, provided that the components originated in that developed country. This ruling was not affected by the fact that such products were processed in a free zone;

(d) Establishment of export-manufacturing zones should be viewed within the global context of the national development policy of the host country, including its export policy, investment policy, regional development and foreign trade policy.

#### IV. CASE STUDIES PRESENTED TO THE MEETING AND DISCUSSION

##### Case studies

Three case studies were presented by free-zone authority officials: B. O'Regan, Chairman, Shannon Free Airport Development Co., Ireland; Hahn Choor General Manager, Masan Free Export Zone, Korea; and Theodore Q. Peña, President Bataan Export Processing Zone, Philippines.

These case studies showed that when import substitution reached the saturation point, export-promotion efforts very often failed in developing countries. A catalyst was usually needed to give the required drive and build up impetus. The organization of an export-manufacturing free zone was part of a State's integrated effort to attract foreign investment and technology, increase employment and exports. In other words, the establishment of free zones linked together various objectives, and was not, as was commonly thought, designed only to promote exports.

A properly organized free zone was a model industrial estate, which served to demonstrate the determination of the host State to attract investment. Potential investors visiting such zones were encouraged to invest; when the free zone was correctly organized, industrial investment - domestic, foreign and joint venture - increased as a result.

##### Discussion

The Meeting noted that most investors in export-manufacturing zones already had established markets, usually in their country of origin. Very often their products had no local markets, so that there was no known case of a zone manufacturer's selling significant quantities of production domestically or in small developing economies in the region.



The Meeting endorsed the view that legal precautions should, nevertheless, be taken to ensure that zone manufacturers do export mainly to developed countries:

It was noted that already the more advanced free zones, e.g. in the Far East, exported some production to developing countries in that region. This was because the local demand had reached a sophisticated level.

Participants from Colombia, the Dominican Republic and Mexico described their experience with free zones, and almost every participant and observer gave a brief outline of his country's plans regarding some form of free zone.

Annex I

PROGRAMME OF WORK

1. Registration
2. Opening session
3. Tour of the Free Zone of Barranquilla and surroundings
4. General session: Presentation of case study on Barranquilla Free Zone: history and experience of the 10 years of operation; group discussion with question and answer session
  - Substantive session II: Possibilities of regional and subregional co-operation between export-oriented industrial free zones and proliferation of free zones in one area leading to unnecessary competition for investor
  - Substantive session III: Policy concerning access of products from industrial free zones to the major free-trade-area country markets, both within as well as outside of such areas, and the rules of origin applicable; Caribbean Free Trade Association (CARIFTA) <sup>a/</sup>, Andean Pact, Central American Common Market (CACM), European Economic Community (EEC) etc.
  - Substantive session IV: Guidelines for physical planning of industrial free zones as a form of industrial investment incentive
  - Substantive session V: Organization of export-oriented free zones and free ports
  - Substantive session VI: Korea - the specific problems experienced in the Masan Free Export Zone (MAFEZ)
  - Substantive session VII: Philippines - the specific problems experienced in the Bataan Export Processing Zone
  - Substantive session VIII: Promotional measures utilized by industrial free zones
5. Discussions and adoption of report
6. Closing session

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<sup>a/</sup> Now the East Caribbean Common Market (ECCM).

Annex II

LIST OF DOCUMENTS<sup>a/</sup>

- ID/WG.185/1      Export-oriented industrial free zones: the potential of export-oriented industrial free zones and some conclusions on the possibilities of co-operation between them  
B. O'Regan, Ireland
- ID/WG.185/2      A case study of the Masan Free Export Zone  
The Industrial Estates Administration, Masan, Republic of Korea
- ID/WG.185/3      Physical planning of industrial free zones  
P. Quigley, Ireland
- ID/WG.185/4      Promotional measures for the development of export-oriented industrial free zones  
A. Weil, United States of America
- ID/WG.185/5      Agenda and programme of work
- ID/WG.185/6      Organization of export-oriented free zones and free ports: study based on Shannon (Ireland), Masan (Republic of Korea) and Hong Kong  
Rajinder Singh, India
- ID/WG.185/7      The long-range growth and proliferation of industrial free zones in developing countries  
UNIDO secretariat
- ID/WG.185/8      Industrial free-zone activities in the Philippines with particular focus on the Bataan Export Processing Zone  
T. Q. Peña, Philippines

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<sup>a/</sup> A limited number of copies of these documents are available from UNIDO upon request. A complete record of the Meeting is also available on 18 cassettes C 60.