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07447

Distr.
LIMITED

ID/WG.244/9
5 May 1977

ORIGINAL: ENGLISH

United Nations Industrial Development Organization

Seminar on Co-operation between Industrial
Free Zones in the Arab Region

Alexandria, 21 February - 1 March 1977

INVESTMENT PROMOTION AND THE ROLE OF FREE ZONES IN THE ARAB STATES 1/

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id.77-3339

The topic of my paper today is to put forward some reflections on investment promotion in the Arab countries and how a proper investment promotion approach can play an important role in the development of free zones there. The Arab countries have a population of over 100 million people, with Egypt alone representing 38 per cent. Per capita income ranges from $25,000 in some Arab oil exporting countries, to about $250 in other non-oil exporting countries. As more and more companies are finding it profitable and attractive to use "satellite" manufacturing facilities in the free zones around the world, some of the Arab countries, like Syria, Jordan, Tunisia and Egypt have already resorted to the free zones concept, among other measures, to attract foreign and Arab investment.

Some Arab countries are trying very hard to attract foreign capital, technology and know-how. The reason is that they have found that there is no other domestic source equal to their needs, that their national sovereignty is not endangered by foreign investment and that benefits derived from foreign capital outweigh disadvantages resulting from it. Even Arab countries with large "petro-dollars" are very keen to attract foreign technology and know-how. Arab funds have to be "married" to foreign technology and unless this takes place these funds will not be effective in playing the important role assigned to them in the development process.

If we take Egypt alone, with its population of about 40 million, and a growth of population, say, of 3 per cent per year, or about 1,200,000, and assume with one-third of the population active economically, then there is need for about 396,000 new jobs per year, just to maintain the status quo. Of this job demand, at least 200,000 new jobs per year must be created by new industrial development. If we assume that on the average one new job is created for $10,000 invested, therefore, $2 billion must be invested yearly in industry to provide 200,000 jobs. In order to reduce significantly the prevailing unemployment and under-employment in Egypt, the investment rate, therefore, should be more like $3 billion. As the internal resources cannot provide such large amounts, then external resources may be called upon to supplement the need. Accordingly, it is clear that unless a strong investment development programme is embarked upon to attract outside resources, the objectives of development efforts will not be fulfilled. For Arab government efforts to succeed in attracting capital (if needed), foreign technology and know-how, there should be a proper project identification, a well-matched project evaluation, supported by a good "marketing" or promotion system.

The investment process starts with intuitive reaction to an economic need. Having identified a need, and the physical possibility of satisfying it in a local production facility or in a free zone, the next step is to compile the basic data which would be required in the future evaluation phase. This data usually covers information on population, wages and salary levels, utility costs, transportation and communication facilities, taxes, pertinent laws, land values, labour union activities, raw materials, existing supporting industries, credit and banking institutions, schools, amenities for foreign expatriates, etc.

The Arab governments can play an important role in the above process by providing the potential investor with needed assistance in compiling, through appropriate agencies, such data. Also, these governments could take the initiative in identifying investment opportunities and bringing them to the attention of potential local and foreign investors. Otherwise, if such initiative is not taken, the country will be dependent on the initiative of local investors which may be inadequate or lacking and the "whims" of foreign investors.

As to project evaluation, although it is the prerogative of the interested investor, yet he also needs government support to undertake it.

The full evaluation of feasibility study consists of two parts -

1) basic data of general application, mentioned above; and

2) the specific economic technical analysis.

The private investor usually accepts the first part. As to the second part, he almost always insists on his own careful analysis of it. He undertakes such analysis according to his specific financial and technical terms of reference. Such analyses which he performs, on which his investment decision is made, are prepared to cover various aspects. One is a market survey estimating current market, future growth and maximum foreseeable demand in a 5 - 10 year period. The other is a process flow sheet which establishes unit processes and operations; raw, intermediate and finished material balances; energy plans and other plant utility requirements and labour force. Another is floor plan, elevation views and equipment list which defines approximate horizontal and vertical building dimensions, floor loading, special structures, equipment sizes, electrical and other services. His capital cost estimate provides information on structures, equipment and installation costs. The profitability and pay-out time gives a precise idea on the rate of return on the investment. This aspect of project evaluation is looked upon from the foreign investor's point of view. However, there is another aspect of project evaluation from the host government's point of view covering social cost and benefit aspects.

It is evident from the above that for an orderly advancement of investment development within or outside the free zone in an Arab country, a "nerve" centre must be established which can serve as a project identification centre, a project evaluation centre, an investment reception centre and as the directing agency for promotional effort. Such "nerve" centre or Investment Development Authority should stand apart from the government though, clearly, it must enjoy government favour and receive government support. Specifically, the function of the Investment Development Authority in promoting investment within the free zone or outside the free zone would be to identify and evaluate projects that would be put forward to the attention of local and foreign investors in addition to the capability to evaluate projects submitted by foreign and local investors. After the projects are identified and evaluated, then comes the next step to promote it to selected financial and technical participants and to provide catalytic assistance in bringing potential partners together, helping them with negotiations and directing them through required government channels. This includes assistance in obtaining government and private loans, both local and foreign. This, of course, assumes that the host Arab country in question has a good investment climate and a favourable investment law with continual adjustment to changing realities. The key action for successful promotion is the skilful presentation to the right people, in other words, there are two factors -

1) to prepare the mechanism that directs the promotion strategy;

2) the right target to which this strategy is aimed.

Specifically, the function of the investment authority in charge of promoting free zone and/or other investment within the country would be -

1. Preparing an investment guide on the country, preferably in loose-leaf form to facilitate the entry of current changes which should include the following -

a) Complete data on the laws and conditions governing the conduct and welfare of firms investing in the country.

b) All pertinent data on the country's climate, geography, infra-structure, utilities, labour supply, management skills, schools and other training facilities, growth trends and other indicators of the country's present economic strength, etc.

2. Working with other co-operating bodies in the country, government departments, existing firms, etc., in identifying potential projects.

3. Preparing "pre-feasibility" or "teaser" studies of selected projects. Pre-feasibility studies differ from full feasibility studies in that they do not contain cost analyses, engineering plans or schedules, plant layouts or profit projections. However, these industrial profiles include -

a. A full definition of the project.

b. Its scope in terms of the function to be performed (i.e. manufacturing, marketing, servicing, etc.) and its proposed scale.

c. All available data on the market for such an industry or service.

d. Information about other interested agencies or firms, technical or financial. (This would include interested potential partners, either governmental or private.)

e. Information on current or potential competitors.

f. The priority given to this project and the forms of government help and incentives available.

g. Proposed sites for the project.

h. Advice, regarding infra-structure and utilities at each site, labour availability, climate, or other pertinent factors for this particular project. (The latter might include soil or mineral analyses.)

i. Availability of raw materials where this is pertinent.

j. Such simple maps and charts as can help to clarify the points listed above.

4. Where there are other bodies in the country working on feasibility studies, the Investment Authority should assist them with the dissemination of their studies.

5. Assisting foreign investors who visit the country to carry out project feasibility studies and on-the-spot evaluation. This includes arranging visits to existing factories, meetings with local businessmen and banks, and discussions with officials of the relevant government departments and agencies.

6. Promoting local companies to upgrade and diversify their manufacturing facilities and assist in the establishment of joint venture activities.

7. Ensuring that new industrial projects are implemented on schedule by solving problems and differences which may be encountered with relevant government departments.

8. Evaluating industrial projects from economic and technical points of view, before recommending the firms to enjoy the incentives offered.

9. Preparing studies on specific industrial sectors and analysing "problem" areas.

10. Producing promotional literature and providing public relations activities such as publicity events for new factory opening ceremonies, etc.

Overseas Offices

Industrial promotion for a free zone, like any other form of selling, must be directed from the point of supply and serviced at the point of sale. It is like a product in a sense, for a product to be sold successfully it requires that the salesman know well his product and understand completely the psychology of his buyer. Likewise, for successful promotion approach, the promotion staff should have, not only a good knowledge of the project to be promoted, but also a broad acquaintance with, and sympathetic and enthusiastic understanding of, the overseas' country from which they are trying to interest its business community.

The overseas offices for the Investment Authority are like the eyes and ears to the body. They keep the Head Office fully informed with the business developments and trends as they relate to the investment climate in the country. In other words, the overseas' office, to the Investment Authority, is like the marketing department to the manufacturing facility, both have to work together through a two-way traffic keeping each other well-acquainted and apprised about the development that takes place on the other side. In order for foreign investment to flow from the target country there has to be a push from there by the overseas office and a pull from the Investment Authority. The role of the foreign office is to take on the job of the "push" and the Head Office is to take the role of the "pull". For the operation "push" to succeed, those in charge have to be well-acquainted with the market they are dealing in, properly well-informed with the economic conditions at home, promptly fed with required information and data from there. For the "pull" operation to succeed, it has to be kept well apprised of the foreign investors, their needs and backgrounds, their plans and their projects, well in advance. For these reasons we find that it is very important to build and strengthen first the Head Office operations to provide the needed back-up support before any overseas offices are opened.

Experience with some Overseas Offices

Developed countries as well as developing countries have realized the importance of proper promotion approaches and techniques in bringing in required foreign capital, technology and know-how. In the case of developed countries, we find that these governments spend hundreds of thousands of dollars to open up overseas offices to fulfil such objective. For example, we find that the Canadian Government has offices in the United States, including New York and Chicago, as well as Europe, to approach U.S. and European businessmen and explain to them how profitable it is for them to invest in Canada within the Canadian Foreign Investment Law. Also, countries like Belgium and France have offices in the United States undertaking the same function. The investment promotion aspects are not undertaken only at the Federal level but also at the State level. We find several Canadian provinces have their own private offices in the United States, each one trying to attract American investors to its province. The objective, of course, is to benefit from the taxes and employment resulting from locating American investment there. By the same token, we find southern U.S. states open offices in northern states, trying to get northern businessmen to locate in these southern states. Not only do U.S. states open offices within the U.S., but they also open offices in Europe, particularly in Brussels, the head of the European Common Market where, for example, the State of Virginia has an office. The States of Pennsylvania and Michigan also have overseas offices while New York has an office in London.

As to the developing countries, we find that the overseas activities are undertaken through opening offices in leading financial and business centres. As such operation requires a large amount of funds, as well as trained personnel, only developing countries which have such capabilities venture to open these overseas offices. For example, we find in Latin America, Brazil, Colombia and Mexico are very active in opening overseas offices. In the Caribbean, Barbados, Jamaica, Trinidad and Tobago; in Africa, Egypt Ivory Coast and Tunisia; in Asia, Hong Kong, Indonesia, India, Korea, Malaysia, Singapore and Taiwan. As mentioned before, the objective of these offices is to bring the identified projects to the attention of potential investors or holders of technology and know-how and elicit their co-operation in establishing subsidiaries, joint ventures or private licensing arrangements. These promotional offices are also able to put forward the investment climate of the country in question and respond to potential investors' queries, arrange for appointments for visiting businessmen and assist them in obtaining from their headquarters, needed information to fill any gaps in the investor's research work, etc. A good example is a small country like Singapore where we find that they have offices in New York, Chicago, Houston and Los Angeles. In Europe they have offices in London, Paris, Frankfurt, Stockholm and Geneva. In the Far East they have offices in Tokyo, Osaka, Hong Kong and in Melbourne. For a country like Israel, they have offices in New York, Chicago, Los Angeles, Atlanta and Toronto; in Europe they have offices at Le Hague, London and Zurich.

The success of these offices, as mentioned before, depends on the back-stopping support these offices receive from their headquarters. It should be emphasized that the process of investment promotion cannot work in a vacuum. In other words, the promotional aspects should be well understood, not only by the investment authority, but by every other governmental and non-governmental organization that has anything to do with foreign investment. For example, for foreign investment to come in, the Ministry of Industry, the Treasury, Customs Administration, the Exchange Control, Central Bank, Ministry of Transportation and Immigration Department all have to work hand-in-hand to facilitate the job of the foreign investor.

They have to speak the "language" of the foreign investor, in other words, they would be speaking on the same "wave length".

Now let us move to the process of promoting the Arab free zones. The promotional process of promoting the Arab free zones does not differ from the promotional process that promotes investment within the Arab countries which was described above. For the Arab free zone promotion campaign to succeed, we have to find some solution to a problem related to the Arab Common Market.

The Arab Common Market agreement specifies that for industrial projects to enter tax free into the Arab countries participating in the agreement, the cost of local content in the Arab country should not be less than 40 per cent of total cost. As production in free zones there is not considered within the Arab country, then it becomes unprofitable for foreign investors to locate, for example, in the Egyptian free zone and try to export to Saudi Arabia because, even if local content was more than 40 per cent, Saudi Arabia, for example, according to the Arab Common Market agreement, will not consider the Egyptian free zone as a port of Egypt and hence cannot enjoy the privileges of the Arab Common Market mentioned above.

Another problem is that most products produced in the Arab free zones do not enjoy preferential customs treatment when they enter the country where the free zone is located. For example, a product produced in the Egyptian free zone has to pay full customs duties when it is exported to Egypt as if such product is produced in a foreign country. If Egypt is keen to promote its free zone, it should give, let us say, a 50 per cent reduction in customs duties when a product is produced in its free zone and shipped to the Egyptian local market. The gains accruing to the Egyptian economy from following such recommendation would far more outweigh the loss in customs duties revenue, especially if it specified that to obtain such privilege a certain percentage of raw material has to originate from Egypt. Needless to say, as a result of implementing such suggestion, the employment of Egyptian labour and the utilization of Egyptian resources will contribute more to the national economy than the foresaken customs duties.

It may be of interest to the responsible officials in charge of Arab free zones to consider what some other countries developed in their own free zones by establishing specialized free zones. For example, India established a free zone for the electronics industry, the Santa Cruz Bombay Airport Free Zone, where the whole area is fully ear-marked for the electronics industry. This way certain economies of location accrue to participating foreign industries and, in turn, attract them to the free zone.

Another area which may be of interest to Arab free zones is to provide industrial profiles for industries that are most suitable for free zone operation. These industrial profiles could be prepared with the co-operation of the relevant industrial development banks and specialized consultants. Puerto Rico spends over $2 million a year on industrial profiles alone, the idea being to make it easier for foreign investors to consider locating there if they find some of the foundation work has already been laid for them.

Another suggestion may be to encourage domestic manufacturers to locate in the free zone by providing lower interest rates than those prevailing inside the country and exempting the fuel used by them from all customs and local taxes if most of its production is ear-marked for export.

Another incentive would be to exempt all export profits from income taxes.

Another incentive may be to develop the free zones by providing partial or full reimbursement for the cost of training labourers, for example, Singapore would reimburse the foreign investor's cost of training if he trained double the number he needs for himself. This would assure availability of trained labour which, in turn, could be used as one of the promotional tools to attract foreign investors.

It would be interesting at this stage to quote what the Ford Motor Company has asked me to bring to your attention as regards its view on free zone consideration for foreign manufacturers:

"A foreign investor generally seeks an investment climate which most satisfactorily enables him to earn a return on his investment. On balance, the Free Zone concept has developed in order to improve the return an overseas investor receives, as well as to reduce problems of conformance to regulations established for domestic commercial enterprises.

Some attractive benefits of the Free Zone concept often accruing to the sponsoring country are:

- Employment of Workers
- Addition of New Industrial Technology

And, for these benefits the sponsoring country has some costs:

- Supply of infrastructure (water, roads, electricity, communications, rail and port facilities, etc.).
- Customs security and administration.

Obviously it is the balancing of the benefits with the costs that a country undertakes in determining the rules under which a foreign investor may operate in a Free Zone. Unfortunately, experience has shown that free zones tend to be "middle" zones, rather than free. The sponsoring country finds it too difficult to shake off the constraints possibly needed on domestic industry and the free zone becomes acceptably attractive only to a few, and generally smaller, investors. To attract the large investor and large employer who can bring significant benefits to the sponsoring country, the free zone rules must have the flexibility to acknowledge his needs.

The principal conditions under which a free zone enterprise may be attractive to a manufacturer are:

- His product is labour intensive. Abundant low cost labour supply and free zone concessions are key factors influencing the investor's decision.
- Opportunity exists for freight savings on products to be sold in the local region. Component or raw material transport may provide significant savings versus freight costs of the completed product. When these savings can be retained without significant deterioration by other penalties, a free zone operation could prove to be attractive.

In the automotive manufacturing business, vehicle assembly proposals have been studied in many markets under a number of different business conditions, both free zone and interior. Our studies show that low volume assembly plants are uneconomic. Assembly of cars and trucks is capital intensive with relatively low labour content. Even with free zone concessions that reduce labour cost and grant taxation advantages, it is virtually impossible to reduce costs enough to equate the finished product cost of a locally assembled vehicle with one imported built-up from a high volume home location. In addition, the freight savings are normally offset with high capital associated costs.

Because of the high capital associated costs, low volume partial manufacture and local assembly of vehicles result in substantial cost premiums versus vehicles imported built-up. In addition, to protect the local industry and ensure sale of the locally assembled high cost production, substantial duty protection is required which would not normally be available under free zone operat' ı.

Although Ford would like to be a partner with countries who want to develop or strengthen their industrial base, low volume automotive assembly is often unattractive to both partners. Generally, the host country is not interested in developing a capital intensive industry which produces high cost products and which requires high duty protection or unusual concessions to assure its survival.

In addition to the foregoing, a unique problem among the Arab countries is that free zone produced products do not meet the local Arab content requirements under the Arab Common Market rules. This constraint could effectively act to reduce the interest of many investors in Arab country free zones.

Aside from automotive assembly, the question arises with regard to the manufacturing of parts or components in a free zone for shipment to home manufacturing locations. Such manufacture would be advantageous only if the additional freight and handling costs involved were offset by labour and overhead savings. Again, because of the large volumes of production required and the need for a high degree of precision and quality control, capital intensive automated processing is normally required, tending to limit opportunities for labour savings. Our studies generally show that when all these cost factors are considered, manufacture of automotive parts and components in a free zone remote from the home location is not economically advantageous."

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