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Review papers

GOVERNMENT MEASURES WITH IMPACT ON THE EXPORTS PROMOTION THROUGH FREE ZONES

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Abstract: The establishment and manner of managing free zones represent the very focus of government development policies of the majority of countries participating in the international trade. Being an efficient solution for a number of complex economic problems at country level, especially in the areas of foreign trade, foreign debt, social policy, demographic policy, foreign exchange operations, economic development of underdeveloped regions, etc., the concept of a free export processing zone (free zone) has become an internationally recognised, often used and more efficient instrument relative to a number of standard instruments of government development policy. Moreover, free zones have shown special potential as an important instrument for export promotion. Improved connectivity of countries via free zones does not only add to the integration of such areas and make impact on their mutual economic and political relations, but also makes more solid basis for improved models of economic and political relations with their partners outside such communities. Various government political and economic goals result in various categories of free zones.

Key words: free zones, export promotion, government, international trade, development policy.

INTRODUCTION

In phenomenological terms, free zones can be traced very early (app. 300 B.C.) in Phoenicia – the town of Tyre and in towns of the Greek and Roman empires. For instance, the Greek island Delos enjoyed benefits of such a status and represented one of the wealthiest islands in the world for the period of one hundred years. Those were places where, according to the circumstances present at that time, trade flourished and wealth was abundant. Rudiments of the free zone idea may be found in the work of the Greek philosopher Xenophon, a disciple of Socrates, who was also interested in the economics. In his *Cyropaedia*, he thinks about ways

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for the Athens state to increase its revenues and the city to prosper, propagating the idea of “hospitality and privileges for foreign traders and mariners”. It is especially striking that he does not even exclude Spartans from such privileges and hospitality. Predecessors of today’s free zones (free export processing zones) were Middle Ages free cities, free ports and free port zones. The first free port was established in Livorno in 1574, followed by Naples, Venice, Genoa and a number of other Italian cities which were well-known trade centres at the time. Free cities were established in Hamburg in 1835, followed by Bremen and Kiel. In 1819, a free port was established in Singapore and in 1842, there was one in Hong Kong.

The main difference between a free port and a free port zone implied customs perimeter. In free port zones, only a part of a port specially equipped for warehousing and reloading of goods was exempted from customs duties. On the other hand, goods imported into free ports-cities were exempted from customs duties, so that customs borders were identical to city borders. 17th century featured increased restrictiveness in assigning the status of a free city, as well as a city zone exempted from customs duties and other levies. In 1888, the free zone *Freihaven* was established in the port of Hamburg, followed by free zones in port cities such as Trieste, Bremen and Kiel. There, the host countries first provided significant fiscal privileges and liberalisation of trade in goods related to construction or furnishing of ships in any manner. Nevertheless, as there is both an upside and a downside in all international trade aspects, free ports and free port cities became Mecca for crime of that period: contraband, smuggling and various forms of illegal trade – primarily in monopolistic commodity, causing a number of cases of abolishing the status of a free port or city in 19th century. This slowed down, not only formally, but also essentially, the development of free zones.

The first modern free processing zone was established in the Irish town of Shannon in 1959 and this concept evolved into the so-called Irish model. The success of this free zone paved the way to the establishment of a number of such institutions in Hong Kong, Mexico, India, Taiwan, Brazil, Singapore, etc. The interest of hosting countries, as well as investing companies, resulted in an increase of their number to 850 at the end of 20th century, including new free zones in China and a number of transitional countries. In time, the number of their economic and development goals and roles increased. Modern zones are not focused on tax reliefs or favourable loans, but on providing conditions for doing competitive global business. This implies improved infrastructure (modern communication, reliable energy sources and transport), well-educated workforce and efficient administration (‘one stop shop’ – offering various logistical services at preferential prices).

Free zones may be established in several ways: with private or state-owned capital or within a public-private partnership (the private capital being the prevailing method currently). The state in whose territory a free zone is established possesses full political power over it. In line with the exports orientation of free export

processing zones, the country of the establishment legally obligates the company (both resident and non-resident) operating within the zone to export a certain part of its output. All of the goods produced in a free zone and marketed are labelled as made in the country of the free zone. National economies may independently and in line with their economic sovereignty limit their sovereignty within clearly defined parts of their territories. Such zones where a national economy has limited customs supervision and where companies may operate more freely with having numerous customs and tax privileges are called free zones or free economic zones (Bjelić, 2008, p. 252).

TYPES OF BUSINESS ACTIVITIES PERFORMED IN FREE ZONES

Today, free zones differ substantially from their original forms, but they retain their important role in the international trade and still represent an important instrument for increasing production and national exports. Depending on the national legislation of each individual country², the most common business activities are: inward processing of goods, industrial production of goods for exports, warehousing and various services. The inward processing activities imply transfer of goods (without paying customs duties) into the zone temporary, changing of their properties by finishing, treatment and processing and their exporting as such. Reasons for this are various and often the intention is to obtain preferential administrative licences. They may be related to import of goods (avoiding of import duties for raw materials), origin of goods, transit processing³, tax reliefs, etc.

Free zones with industrial production of goods for exports have special government treatment implying various incentives and tax reliefs. All companies in the wider zone area both of the host country and neighbouring countries would have an indirect positive effect of industrial production in a free zone due to the fast penetration of new technologies, as well as managerial and organisational solutions. The warehousing activities imply several forms in practice, most common being the pure warehousing of goods within a free zone or combined warehousing. The former case implies no additional manipulation of goods, unlike the latter case where goods may be sorted, assembled, disassembled, labelled, cleaned, reloaded, uploaded and downloaded. The common feature of both types of warehousing is

²Legal regulations in all countries are rather liberal on business activities which may be performed within a free zone and accordingly, various business activities are performed, with observing the condition of not jeopardising lives and activities of people within the free zone and its wider area in any way.

³Goods are imported from country A, cheap workforce and raw materials from country B where the free zone is located are used, and the goods are intended for exports to country C.

the prohibition of changing core properties or purpose of goods. In literature, there are opinions that free zones should be completely replaced with customs warehouses. However, it is not acceptable since the two institutes have completely autonomous functions and essentially different roles in the international trade. This complies with the EU legislation which accepts two types of free zones - control type I free zones and control type II free zones. Control type I: characterised by certain perimeter fence with customs unit at entrance; goods enter such free zone with accompanying documents; Control type II: no fence, no customs unit at entrance or exit; goods are subjected to a declaration; essentially coming down to a standard customs warehouse. Free zone users enjoy a large number of privileges which customs warehouses, due to their institutional nature, cannot provide. This leads us to an apparently harmless question related to the efficiency of a customs unit within a free zone: do efficient customs within a free zone ensure detection and suppression of illegal activities within the zone or do efficient customs facilitate, to the greatest possible extent, legal trade? The best possible answer would be that the government, through customs operating within a free zone, facilitates legal trade to the greatest possible extent, without neglecting the responsibility for detection and suppression of illegal activities. To the honest businessman this is a refreshing attitude compared to the more traditional attitude of hindering all trade in the hope of finding some illicit trade. (Haywood, 2000a). In order to fully understand the term of free zone, it is important to explicitly differentiate between the following similar terms with essentially different meanings which often cause confusions:

Free processing zones – A free zone occurs when in a certain area of a national economy manufacturing exempt from customs duties and with lower taxes is organised. Being clearly territorially defined and physically bordered, it represents an island within a customs territory of a country (Bjelić, 2008, p. 253) and therefore, it is also colloquially, but incorrectly, called a customs free zone. It is called a free processing zone due to the fact that predominant activities are manufacturing and processing of goods by manufacturing companies. A free zone as an institute is associated with production incentivising, predominantly referring to export-oriented industrial production, capital investments and foreign trade promotion. Privileges for companies operating within a zone are allowed only if such companies export goods produced within the zone, and therefore, the term free export zone is often used. Exports of goods produced in a free export zone to third countries represent imports for such countries, performed in line with foreign trade regulations of the importing countries. Customs procedure and payment of imports customs duties comply with laws and regulations of importing countries. Placement of goods and services from a free zone to the host country territory is treated as imports and is subject to customs regulations of the host country. In case the products in question contain a domestic component, customs duties will be calculated by reducing the customs basis by the value of such component (Kozomara, 2003a). Meaning, in

case goods manufactured in a free zone are sold within the host country, such host country will pay customs duties as in the case of standard imports. Unlike a customs zone, a free zone may be in customs terms merged to other customs territory (of the host country) with being subject to other customs sovereignty. Such situation of a country using a part of the territory of another country as a free customs zone is positive not only from the foreign trade aspect; it has a positive effect to bilateral relations of the two countries, creating long-term strategic partnership.

Free trade zones/foreign trade zones/off-shore zones – Unlike free processing zones, they are not territorially separated from customs territories of the countries and they may even cover whole countries or a specific industry, but they are limited to doing international business only with foreign companies. The mechanism behind them is the following: a national economy decides to apply much lower tax rates (if any) to income and operations within a zone for companies doing mainly international trade. By applying favourable taxation and removing other barriers to international trade, with also applying laws which guarantee discretion of bank deposits, investments and business transactions, companies from developed countries are attracted. Therefore, such economies are called ‘tax havens’. Unlike free processing zones, free trade zones cover entire territories of national economies, but tax reliefs apply only to companies doing business with companies outside such economies, i.e. to off-shore business (Bjelić, 2008, p. 254). According to the International Labour Organisation (ILO, in the period 2007-2009, 20% of global turnover was made through free zones. Their number is actually the largest in the finance sector. There are also other specific free trade zones, such as the free insurance zone in New York, the USA. If a premium is high enough (app. over USD 100,000), insurance regulations of the New York State do not fully apply. The logic is the following: if an individual is able to pay such an insurance amount, the individual can protect himself/herself better than the state can (Haywood, 2000b).

New ways of doing business illustrate changes in the international economy. In addition to off-shoring, there is also outsourcing⁴ and off-shoring combined in case a company subcontracts its business or a factory abroad to another company. Reverse off-shoring is the latest phenomenon implying the case when a foreign company relocates a part of its operations (marketing, management) to the USA or a similar country, leaving the production part requiring cheaper workforce in its country of origin. There were a large number of such companies in the USA, due to the volume of the American market and their competitiveness. The underlying concept of free trade zones is that they represent an alternative state policy which promotes goals of the states. Sometimes, the concept covers a geographical region,

⁴Outsourcing is delegating a part of operations to an external organisation (outside the company but within the same country) specialising in the particular operations. This practice has been applied from 1980s.

but it often encompasses only a specific industry, such as banking, insurance, export-oriented companies or technology exports, and even immoral activities such as gambling and prostitution in places such as Monaco, Las Vegas, Macao or North Korea (Haywood, 2000c). In the literature, we may often see that ‘free zones are not free’. This is correct because they are in legal terms controlled by government institutions which established them and they cannot act autonomously regardless of the difference between regulations applied within the zones and in remaining territories within certain economies. At first sight, it may be confusing that regulations applied within a free zone are most often more liberal (e.g. LB regime of exports and imports) than regulations applied in the remaining territory of a country, not implying, however, that customs control is negligible, but the opposite.

Customs zones – A part of the territory of a certain state where goods under certain procedure and customs supervision is placed. Within customs zones, less complex activities are performed, such as warehousing, repacking, processing, finishing, customs clearance prior to distribution, etc. No manufacturing is allowed, and only allowed actions on stored goods are those necessary for their maintenance and preservation. They facilitate customs procedures and help in overcoming customs barriers in foreign trade. They are always an integral part of the territory where they are located, unlike free zones.

Free zones as the level of development of regional economic integrations – Several countries found a common interest in forming a free trade zone, such as the North American free trade zone or the North American Free Trade Agreement (NAFTA) formed by the USA, Mexico and Canada in 1994 with the area of over 21.29 million square kilometres. Such free zones support dynamics of mutual trade of member states, produce effects of the economies of scale, lift customs and off-customs barriers of member states in mutual trade, attracting FDIs from non-member states. A common mistake is the misuse of terms – common markets such as the EU, or customs unions such as MERCOSUR and zones of free trade such as the NAFTA and the proposed FTAA are not free zones. Free trade *zones* are predominantly established within one state, with several examples of inter-state zones, whereas free trade *areas* are established among states. In addition to economic ones, there are certain political motives in establishing a number of free zones worldwide, such as negotiations of the Customs Union led by Russia and Turkey from 2014 on potential joint establishment of a zone of free trade. Actually, this was a certain message to the EU from Turkey that had been the candidate for accession for decades and a potential sign of Turkey’s approaching to the BRIC countries. The Tripartite Free Trade Area (TFTA), a trade agreement on establishing a common African market, being work in progress for over five years, was initially signed in 2015 in Sharm el-Sheikh (Egypt) by representatives of three regional communities: Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC) and Southern African Development Community

(SADC). It was intended to be an African zone of free trade with the area from Cairo to Cape Town. Such zone of free trade composed of 26 countries and 626 million inhabitants and aimed at lowering mutual trade barriers would consequentially facilitate movement of goods and attract investors. The Agreement is expected to come into force in 2017.

Regional trade areas have a similar problem as zones among federation states – former customs problems become police problems due to removal of border crossing points (Haywood, 2000d). The fact that free zones have different customs regulations and that they may have special customs authorities may mislead into believing that they are not controlled. They are absolutely controlled. Even certain parts of the Kyoto Convention from 1979 (Annex F1 regulating customs) and the Vienna Convention against Illicit Traffic in Narcotic Drugs from 1988 see free export zones as zones outside border and customs territory of a state. In the said Annex 1, they are understood as being outside standard customs policy and not as an alternative customs regime. The majority of countries do not support the Annex, and the ones that support it ignore certain points. Small zones with areas of 50 – 500 ha are usually recognised as free trade zones. On the other side, millions of people live in large zones and there are often a number of smaller free zones with special purpose inside them. An example of such zones is the Special Economic Zones of China which were a pioneer in this category. International organisations approve the establishment and operation of free zones and they even incentivise governments to move in this direction. Free zones may be established under autonomous government enactments, as well as international bilateral or multilateral agreements.

MOTIVES OF HOST COUNTRIES FOR ESTABLISHING FREE ZONES

Varying by country, there are different economic, social, political and other circumstances underlying motives for action and priority goals of each individual country. Namely, the establishment and successful operation of the free processing zone in Shannon were supported by the following two facts. Firstly, due to the modernisation of airplanes, they did not have to land on the Shannon airport for kerosene refill, so that the airport became oversized and had surplus staff. Secondly, Ireland faced intense migrations of its population. In face of these problems, the Parliament passed the law on forming a fund for the establishment of a free industrial zone near the airport and accordingly, the company Shannon Free Airport Development Company was formed. In addition to trade and tourism, the company was engaged in production intended for the international market. Consequently, the airport and the industrial zone in its territory became an enclave exempted from Irish customs regulations (Kovačević, 2002a, p.147). In Taiwan, the establishment of zones was motivated by the wish to attract investors and boost exports. In

Philippines (Bataan zone), the motive was to support the development of underdeveloped regions. In Mexico (Maquiladora zone), the reason was the intention to stop the migration of Mexican workforce to the USA. China wanted to attract foreign capital.

The key preconditions for the successful establishment of free export processing zones from the host country standpoint are the following: positive and active approach of the government to the implementation of the free zone concept in its territory, geographically favourable position of the zone – with especially attractiveness if being a crossroads of important routes (river, sea, land), stimulating law on free zones free from all legal obscurities, attracting level of financial reliefs and benefits, transport infrastructure in place, cheap workforce and high-quality management, political stability and legal certainty, liberal imports-exports regime, minimised administrative procedures, investments guaranteed through agreements with other states, small transport costs and high-quality promotion.

The standpoint of the World Trade Organisation (WTO) to FEPZs is that their operation is not prohibited, due to the fact that they are considered the forms which support the expansion of international trade. Declaratively, the WTO aims at the form of trade done within free zones – customs and taxes free trade. In the literature, there is an objection to the WTO that there is no clear standpoint on the future status of free zones since they practically separate the host country's foreign trade policy into two 'sub-policies', the one applicable to businesses within the zone and the other applicable to businesses outside the zone. Further, the opinion of the WTO is that effects of free export processing zones to the global economy are nearly the same as the effects of subsidies. These experts' argument relies mostly on the fact that the WTO principally prohibits exports subsidies (Agreement on Subsidies and Countervailing Measures), whereas companies within free zones use exports subsidising in various manners, through tax reliefs, exemptions from paying imports charges or in another manner. Nevertheless, in the WTO's practice, free export processing zones have not been the subject of any dispute or explicitly mentioned in any document. WTO agreements do not directly treat the FEZ concept, but the Agreement on Subsidies and Countervailing Measures represents the international standpoint on this issue. It is especially reflected through the fact that exports subsidies are prohibited in the majority of countries since 2003 and local content subsidies are prohibited in all countries. This means that many countries will have to revise their free zone laws in the following years and certain types of zones will completely disappear. The structure of economic incentives will be changed in order to alleviate or avoid conflicts of interest. Noteworthy, these rules cover only goods and not agriculture or services, and therefore, they will not affect customs-free regulations in many cases. They do not cover tax reliefs specifically provided for production companies in order to stimulate exports either (Haywood, 2000). Free zones in the territories of member countries of the WTO, the EU or any other

similar regional integration are more attractive for corporate investments due to the fact that penetration to markets of all other member countries is facilitated. This is even more important motive in attracting foreign capital to a free zone than solid raw materials base, developed infrastructure or workforce characteristics (primarily its low price). On the other side, literal globalists believe that the WTO will, through its rules, achieve the level of liberalisation of trade among countries sufficient to minimise customs levies, thus eliminating advantages of production within FEPZs relative to other parts of countries, concluding incorrectly that such zones do not have the future (Kozomara, 2005a, p. 528).

OVERVIEW OF FREE ZONES WORLDWIDE

There are about twenty different names for various types of free zones in the world, some of them being: special economic zones (SEZs)⁵ – China, Poland; free economic zones – Russia; free zones – Turkey, Ireland, Venezuela; maquiladoras – Mexico; free trade and industrial zones – Iran and free export processing zones – Philippines. The practice of launching free trade zones in Latin America emerged in 1920s, first in Argentina and Uruguay and then spreading all over the region in 1960s and 1970s. There, they were also understood as a potential mechanism for development purposes. There are a number of types of free zones in Latin America formed in line with government goals and national characteristics, forming the following six broad categories of free trade zones (Braga, 2002b):

1. Mexican, Central American and Caribbean *maquiladoras* (a factory imports both raw materials and machines with no customs duties, then exports the products usually to the country of the equipment importing);
2. Brazilian EPZs (export processing zones) and Argentinean ‘*zonas francas*’ (free economic zones);
3. Manaus (the capital of the Brazilian province Amazonia) FTZs and Argentinean Special Customs Zone Tierra del Fuego (an archipelago off the southernmost tip of Argentina across the Strait of Magellan);
4. Other MERCOSUR FTZs of Uruguay and Paraguay;
5. FTZs of the Andean community, and
6. Chilean FTZs.

Regionally largest is the Brazilian free trade zone *Franca de Manaus*. It was established in 1967 by the Brazilian government amidst the Amazonian rainforest with the aim of attracting foreign investments to the area and boosting its development. Its operating licence was valid until 2023 and in 2014, it was extended to fifty more years – until 2073. Due to its location and size - 11,401 km², Manaus

⁵ SEZs belong to the group of largest zones with a huge number of employees.

is a unique combination of rural and urban power and potential. In 2002, there were over 300 industries with 50,000 employees. App. 97% of its production is placed in the local market, as the case is with the zone Tierra del Fuego, and therefore, they are called 'imports processing zones'.

In the period from the establishment of the first modern free zone – Shannon to date, app. 5,000 free zones have been established worldwide and according to estimates, over 20% of total international trade is done through them. More prominent zones worldwide made gradual progress, from small and strenuous production to capital and expertise, development centres, global logistics and corporation headquarters. Modern zones are not focused on tax reliefs or favourable loans, but on providing conditions for doing competitive global business. This implies improved infrastructure (modern communication, reliable energy sources and transport), well-educated workforce and efficient administration. But it also implies efficient customs operation (Haywood, 2000f).

“The first USA zones were established in 1934 in free port areas, offering the possibility of liberal transport and processing of foreign goods and aiming at boosting and improving foreign trade and opening new jobs. Since 1950, the USA free zones have been offering the possibility of manufacturing, displaying and stock exchange sale of almost all types of goods. Therefore, from 1980 to 1990, 156 basic free zones and 145 sub-zones were established in the USA, resulting in the increase of exports through free zones as hubs from USD 1.55 billion in 1980 to over USD 125 billion in 1990. In 2001, the New York State gave concessions for establishing 58 free zones or their sub-zones with huge fiscal and other privileges in order to move industrial and manufacturing plants from the New York City area to its surroundings” (Miloš and Rudić, 2005, p.126). In 2013, the EU had 74 free zones subjected to the EU’s customs regulations. Some of more prominent zones are the Shannon free zone – Shannon Duty-Free Processing Zone (SPZ) which evolved into an industrial park on the west coast of Ireland, the Portuguese Madeira Free Trade Zone and the Polish Katowice Special Economic Zone.

According to the 1923 Agreement, Greece gave a concession to the Kingdom of Serbs, Croats and Slovenes for using a part (94,000 square kilometres) of the Thessaloniki port as its customs free zone for the following 50 years. The concession expired in 1975, ratification documents were exchanged, the last anchored ship was unloaded, cargo receipt and shipment were stopped, and the Thessaloniki port, as an excellent strategic and geographical location (crossroads of Europe, Asia and Africa), has recently become an investment target for China. Serbian legal regulations envisage establishment of free zones with local, foreign and mixed capital. In 2015, there were 13 free zones in Serbia. For the Serbian economy, the most important are the following existing large free zones: Pirot, Zrenjanin, Novi Sad and Subotica. The fDi Magazine of Financial Times included two Serbian free zones among 34 best free zones worldwide for 2014: Free Zone Zrenjanin – in the

category of incentives offered to investors and the Free Zone Pirot – in the category of incentives offered for reinvesting. In recent years, the majority of prizes went to free zones from the UAE.

There is an interesting case of inter-Korean economic cooperation through the Kaesong Industrial Complex – KIC. It was established as a joint venture and located in the north, close to demilitarised zone, representing the largest North Korean special economic zone. It also has a unique status and different legal and administrative regime relative to other SEZs in North Korea. By 2013, it attracted 123 South Korean companies which employed over 50,000 of North Korean and app. 800 South Korean workers. In 2013, there was a period of suspension of its operation due to political tensions between the two countries. It is assumed that opportunity costs from the suspension of inter-Korean economic relations were not equal and that South Korea, as the less dependent partner, was less vulnerable and that the situation, as any other, was less costly for it. After reopening of the zone in the same year, the majority of South Korean investors returned. At the same time, the two countries opened the issue of international investing in the zone for the first time. Due to their characteristics, free zones in China are analysed in more detail here.

SPECIAL ECONOMIC ZONES IN CHINA

The establishment of four special economic zones in the coastal area in 1980 marked the beginning of free market reforms of Deng Xiaoping, implying the first step of China into the period of its fascinating exports and growth. For five consequential years, its economic growth stood at app. 10% p.a., resulting in the 2007 income per capita of 19,000 yuans or USD 2,760. In 1978, the income per capita was only 380 yuans.

A side effect of the establishment of special economic zones was the attenuation of the shock of opening the Chinese economy to the world, since such manner had proved to be politically more acceptable in practice of a number of countries than radical economic measures. Foreign capital was attracted also by large privileges for investing in the Chinese zones, regardless of the fact that they were established in areas with no infrastructure and industry, which was another characteristic of the Chinese development. A large number of reform moves were first tested in the SEZs and then spread to other regions up to the country level. In a certain manner, SEZs served as ‘experimental laboratories’ for reforms of the whole country and by its nature, the major effects of the SEZ concept showed to be justified on long-term.

Chinese special economic zones were predominantly established in 1980s in cities-ports Shenzhen, Shantou, Zhuhai, Xiamen, Hainan, with special areas

established within them and intended for technological and economic development. For the establishment of the first special economic zone with tax and trade privileges the city of Shenzhen – near Hong Kong was selected. The island of Nagnan was completely turned into a special economic zone. Chinese special economic zones cover very large areas with millions of inhabitants. They often contain smaller free zones with special purpose having significant independence which encompasses legal, administrative, executive and sometimes court functions. They may have their own customs, taxes and even ministries of foreign affairs. The independence caused some zones to flourish but it also has its downside with smuggling and similar illegal activities which are additionally supported by price disparities within zones and outside them.

An objection to the Chinese concept of SEZs is the problem of crime and corruption present in them, as well as favouring of development of some regions on account of others.

One of the largest Chinese zones Shenzhen, near Hong Kong, received USD 15 billion of foreign investments in its first stage of development (Braga, 2002a). Shenzhen zone was transformed from a small fishermen town with no economic development base to a large, modern and cosmopolitan city with population of 14 million people. This economic centre, together with 8 other cities-zones such as Zhuhai, initiated the development of the entire Pearl River Delta region surrounding the South China Sea, making it a Pearl River Delta Economic Zone phenomenon.

Figure 1. Pearl River Delta Economic Zone



Source: HKTDC Research

Figure 2. Participation of Pearl River Delta Economic Zone in GDP of China

PRD Composition of GDP (%)			
	1990	2008	2013
Primary Industry (%)	25.8	2.4	2.0
Secondary Industry (%)	45.3	49.9	45.3
Tertiary Industry (%)	28.9	47.7	52.7

Source: Guangdong Statistical Yearbook 2014

Source: HKTDC Research.

Differences in conditions for doing business within Chinese free zones and outside them are large. The differences are visible in the areas such as: registration of corporations, fx operation administration and customs administration. “Comparison of free trade zone and non-free trade zone: Free trade zone - 1) Bonded system is adopted in free trade zones. The goods transported into the free trade zone from abroad, or vice versa, shall be exempted from the import duties, and import and export license. The goods transported into domestic non-trade zone from the free trade zone are regarded as imported goods; and vice versa, exported goods; 2) EDI system are applied in free trade zones with computer network linking between customs and enterprises.

Non-free trade zone - 1) Bonded system is only carried out in bonded warehouse or bonded factories. For goods shipped into China from abroad, the import customs clearance shall be proceeded; and vice versa, the export customs clearance shall be proceed; 2) Only a few large-scale enterprises are approved to employ EDI for customs declaration.”⁶

In August 2013, the State Council of China approved the establishment of a pilot free zone in Shanghai. The idea was to use the pilot zone to support Chinese global competitiveness, enable free flow of capital, facilitate trade and investments in key segments, build a new improved platform for cooperation with other countries and contribute to efforts in establishing the ‘new concept of Chinese restructured economy’, improve transformation of state functions, enable more thorough reforms and more intense opening of the economy and spread its positive experience to other parts of the country. Initiation of a pilot project within a limited zone was a cautious and prudent move of the Chinese policy since potential mistakes of the concept may be more easily observed and removed in the process on a smaller area. Covering 28.78 square kilometres, the new zone was built on the basis of existing bonded zones – Waigaoqiao Free Trade Zone, Waigaoqiao Free Trade Logistics Park, Yangshan Free Trade Port Area and Pudong Airport Comprehensive Free Trade Zone. The control and management of the zones follow

⁶ Kaizen Corporate Services Limited. Available at <http://www.by-cpa.com/html/news/20076/754.html>

the same model thus facilitating and promoting trade better, primarily in key, high technology areas and segments.

Figure 3. Areas covered with Shanghai's Free-Trade Zone



Source: China's Free Trade Zones, Presented by Richard Cant
Originally from the Wall Street Journal

Export processing zones, bonded logistics parks, cross-border industrial zones and the newly-established special supervision area will all be integrated under the umbrella term comprehensive bonded zones. It seems that the FEZ concept is not inexhaustible and that it has, as all other things, its natural limits. What works in manufacturing may not work in other sectors. The Shanghai Free Trade Zone, launched in 2013 and focused on finance, has been disappointing according to some opinions. Economists fret that it is impossible to tinker within the zone with China's capital controls, for instance, without the effects spilling over to the rest of the economy. Perhaps as a result, the authorities have been cautious: in a recent survey, three-quarters of American firms in Shanghai said the zone offered them no benefits.⁷

⁷ The Economist, April 4, 2015, Available at: <http://www.economist.com/news/finance-and-economics/21647630-free-trade-zones-are-more-popular-everwith-politicians>

Table 1. Comparison of China’s FTZs

	Shenzhen	Xiamen Xiangyu	Ningbo	Zhangjiagang	Shanghai
Size	3.42km ²	9km ²	2.3km ²	4.1km ²	11.03km ²
Key Sectors	Warehousing, logistics, trade, export processing	International trade, export processing, transit trade	Electronics and information, manufacturing and processing	Logistics of chemical products, warehousing	Free trade, export processing, logistics
Current State	Major investors: Wal-Mart, Sony, Samsung, AEON	Major Investors: Micron, Maersk	Major Investors: Exxon, Samsung, Carrefour	Major investors: Chevron Phillips, Dow Chemical	Major Investors: Intel, HP, GE, IBM
Advantages	-Largest export base in the Guangdong Province -One hour from airport -All 4 trade zones located in Shenzhen Special Economic Zone	-Close to Taiwan (attract investment easily) -19th largest port in the world by container traffic	-3 hour drive from Shanghai -near Beilun Harbor, 4th largest port in terms of container traffic	Connected with the Yangtze River and the sea, within a 2 hr drive of Shanghai, Hangzhou, Suzhou	- First FTZ with the concept of a free trade port -Draws a large talent pool from Shanghai
Limitations	-High investment costs -Zone lacks land resources -Zone is easily affected by global economic situation (foreign exchange rates)	Typhoons hit Xiamen yearly	-Utility, land, and labor costs are high -Very sensitive to foreign exchange rates	Fierce competition from other development zones in Jiangsu Province	Operating costs are high

Source: Dezan Shira & Associates, Richard Cant, March 13, 2014

Attempts to replicate the successful ‘Chinese model’ of special economic zones have not yielded satisfactory results. Theoretically, everything seems possible, but the Chinese economy and social setting are unique. In such a surrounding, everybody ‘gambles’ on development. Nevertheless, the main, unhidden idea of Chinese FEZs – entry into the international market is already justified.

WORLD FREE ZONE ORGANISATIONS

World Economic Processing Zones Association (WEPZA)

The WEPZA’s foundation in Colorado (USA) in 1978 represented an important step in improving the efficiency of zones and their mutual cooperation. The foundation was initiated by the UN and the WEPZA’s main body is the Secretariat led by the Secretary General. The Association has a business, but non-profit character. The WEPZA is authorised to present possibilities of member zones and their interests at international organisations. Membership in the Association brings positive effects of the economies of scale through unified procurement of member zones, jointly organised transport, joint promotion, etc. Advantages are also present

in the selection and training of managers of free zones within the WEPZA, where positive experiences in managing a zone are much more efficiently transferred. Conferences organised by the WEPZA are a possibility for exchanging business information between member zones.

World Federation of Free Zones (FEMOZA)

Aiming at the promotion of free trade and the improvement of a range of other goals of free zones, especially in developing countries and transitional countries, this non-government and non-profit organisation was founded in Geneva in 1999. Its main body is the Executive Committee composed of 5 members, elected by the General Assembly every 5 years. Its membership may be active, honorary and associated. Active membership may be taken by private individuals or legal entities, national authorities or associations, with the EUR 1,000 membership fee. Such members have a number of benefits including technical training in various areas, access to a specific database of international production and trade, logo of FEMOZA on all documents, international promotion through the organisation etc. In addition to membership fees, the organisation is financed from marketing activities, event organisation, sponsorships, etc.

World Free Zones Organisation (WFZO)

This new, multinational and non-profit organisation of free zones was established in Geneva, Switzerland, in 2013 practically as a supervisory body in charge of certain economically fastest-growing regions in the world. The headquarters will be in Dubai (UAE), not by chance, considering its contribution to the development of free zones worldwide since 1980s. Currently, there are 22 very successful zones in Dubai and app. 25% of UAE's GDP comes from free zones. They also make 75% of the country's exports. The board managing the organisation is composed of managers of free zones from 14 countries worldwide. The board is chaired by Mr. Mohammed Al Zarooni, Director General of the Dubai Airport Free Zone and Silicon Oasis. The WFZO has a discretionary right to limit membership, although all UN member countries have the right to apply for it. The membership will have three possible forms: full membership with voting right; associated membership without voting right (companies from free zones) and observer status (UN agencies or agencies of similar multinational bodies). Despite the fact that free zones observe the business rules of the WTO, they do not do it to the full extent. Therefore, ethical business norms and safety will be some of top WFZO functions.

CONCLUDING REMARKS

The strength and credibility of the free zone concept increased over years, so that it was accepted by a growing number of countries. Today, around one fifth of the international trade is done through free zones which are capable of being a tool of integrative policy of economic development. The notion that free zones are static, demanding to maintain, focused on small regions, exploited enclaves stimulated by incentives or privileges is overcome. Perceptions of free zones are different today. They are seen as a dynamic concept attractive for investments and led by high-quality management. Despite the fact that there are examples of unsuccessful free zones in the international practice (mostly due to bad locations, infrastructure or uncompetitive regulations), the majority of zones have achieved the goals of their establishment. Each country or region has its sovereign right to regulate its free zones so that the type and percent of benefits which may be obtained vary accordingly. Although regulations for the majority of free zones are very similar, potential costs and gains must be weighted in each individual case of investing. Transport and customs procedures are very expensive nowadays and free zones are capable of relaxing them. General advantages lie in the following: economies of scale, economic synergy, efficient customs procedure, tax reliefs, logistic efficiency and smaller workforce expenses. Local administrations may offer additional benefits.

The free zone mechanism supports exports-based industrialisation and in cases of developing countries – it may be used for reducing regional misbalances. The range of achieved effects of FEPZs in different countries is substantial: from very positive, through medium ones to those below expectations. Countries which have recognised the potential for their development in free zones are today among most dynamic in the world. Free export processing zones have emerged worldwide primarily due to positive experiences of the following countries: China, Taiwan, South Korea, Philippines, Malaysia, Hong Kong, Ireland, Mexico, Brazil, UAE and Turkey. Considering the fact that free zones represent a mechanism for exports promotion free from all WTO restrictions, they are even more important for countries in need of both investors and exports effects. In the literature, there is an objection to the WTO that there is no clear standpoint on the future status of free zones since they practically separate the host country's foreign trade policy into two 'sub-policies', the one applicable to businesses within the zone and the other applicable to businesses outside the zone. With the adoption of the free zone concept in 1970s, not only China, but other Eastern Asia countries as well stepped into accelerated liberalisation, limited and locally controlled though, which was more efficient than promoting unified liberalisation of all industries and all services. In this way, these Asian countries had control over the process of their economic opening, stimulating at the same time exports through facilitated availability of

import material for selected industries, without completely reducing imports barriers. Free zones are often used as experimental laboratories for implementing new policies and approaches. This was the case with the Chinese pilot free zone in Shanghai. Economic interdependence through free zones opens also nonconventional and unexpected political solutions for many problems among sometimes even ‘hostile’ countries. An example is the Kaesong Industrial Complex representing the key barometer for inter-Korean relations. These are relations between geographically close, but politically distant countries North Korea and South Korea.

Free zones are an important political tool which fully legitimately operates in international relations. Despite their flaws, free export zones represent a very efficient tool for the development of countries and the promotion of their exports.

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DRŽAVNE MERE KOJE UTIČU NA PROMOCIJU IZVOZA KROZ SLOBODNE ZONE

Apstrakt: U samom fokusu državne razvojne politike većine zemalja učesnica međunarodne trgovine, nalazi se osnivanje i način upravljanja slobodnim zonama. Svojim efikasnim rešavanjem niza složenih državnih privrednih problema, posebno u oblastima spoljnotrgovinskog poslovanja, spoljnih dugova, socijalne politike, demografske politike, deviznog poslovanja, privrednog razvoja nedovoljno razvijenih područja i drugih, koncept slobodne eksportne proizvodne zona (skraćeno - slobodne zone), se nametnuo kao međunarodno priznat, često korišćen i efikasniji instrumenti u odnosu na niz klasičnih instrumenata državne razvojne politike. Slobodne zone su poseban potencijal ispoljile i kao značajan instrument promocije izvoza. Viši stepen povezanosti zemalja kroz slobodne zone ne samo da pojačava integrisanost ovakvih područja i utiče na njihove međusobne ekonomske i političke odnose, već je sam stabilnija osnova za povoljnije modele ekonomskih i političkih veza sa njihovim partnerima kombija ovih zajednica. Različiti politički i ekonomski ciljevi država diktiraju sam različite kategorije slobodnih zona.

Cljučne reči: slobodne zone, promocija izvoza, država, Međunarodna trgovina, razvojna politika.

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