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Accelerating Growth of Free Trade Zones

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"We're going to have lower shipping charges, faster delivery coming into the free-trade zone, so there are going to be many benefits,"[1] Mr. Diego Piacentini, Vice President, International Consumer Business, Amazon

"Rising commercial property costs in places like Dubai are enabling us to reap the benefits of the abundance of land, low-cost energy, and skilled staff that we have at our disposal,"[2] Mr. Jamal Aziz, CEO of Sohar's Freezone, Oman

For many countries around the world, free trade zones (FTZs) offer a good option to create jobs and improve the living standards of a large number of people. FTZs, with their tax incentives and relaxed regulations are also seen as means of economic diversification and development for capacities for manufacturing from the bottom up.

In the GCC, the UAE has over time, gained a reputation as a stalwart in the field of economic diversification through FTZs. Strategic use of FTZs has helped in Dubai's multipronged efforts to turn into a regional and global trading hub. Various GCC countries seem to have their own model or strategy for FTZs. However, there are lessons that could be learned from the UAE's FTZs experiences.

In terms of innovation in the use of FTZs, the UAE is considered a global template in terms of effectively setting up a wider array of FTZs that cater to much sought after benefits for investors such as 100% foreign ownership rights, profit and capital repatriation in full, customs duty exemptions, etc, which has helped Dubai to consistently rank among the top leading global business locations. One of the key takeaways from this research is that FTZs can feed into the strategy of effective capacity planning and a knowledge society that promotes the private sector.

Moreover, FTZs all over the GCC need not conform to a singular model. For instance, in the Kingdom of Saudi Arabia (KSA), the focus is on developing entire cities under the rubric of 'Economic Cities', which the country looks upon as a further innovation on the concept of FTZs. FTZs are now a vital cog in the wheel of globalized commerce. Thus, an effective policy framework to guide the sector is paramount, enabling further innovations.

[1] With respect to Amazon set to install a presence in Shanghai Free Trade Zone, China; 2014
[2] With respect to the competitive advantage that Soha free zone has over other regional zones; 2014

Free Trade Zones (FTZs) – A General Introduction

It is now regular practice for many countries to dedicate certain areas within their borders as a free trade zone

It is now regular practice for many countries to dedicate certain areas within their borders as a free trade zone (FTZ)[3]. FTZs aid in minimizing international trade barriers, which allows exporters and importers to operate under more salubrious economic conditions, than usual. The U.S. Small Business Administration (SBA) defines a FTZ as follows[4] –

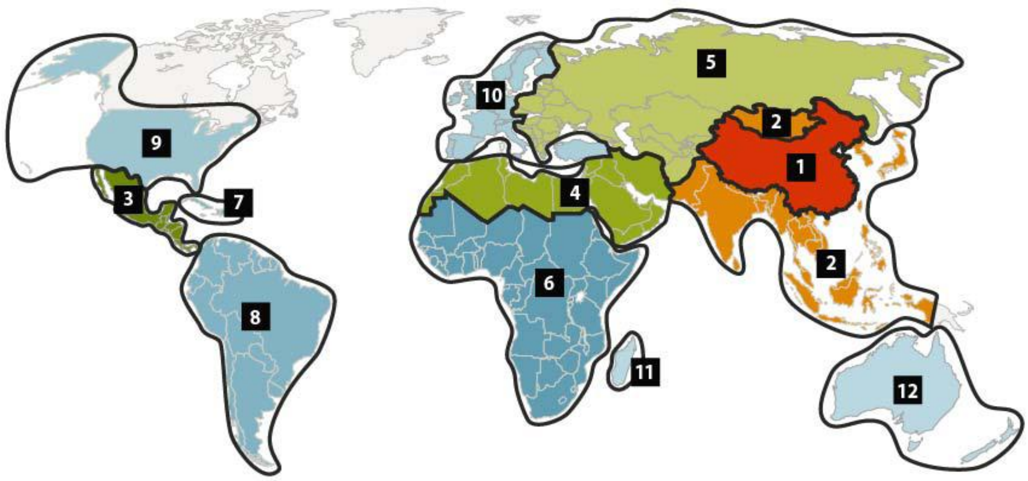
A free trade zone is a designated area that eliminates traditional trade barriers, such as tariffs, and minimizes bureaucratic regulations. The goal of a free trade zone is to enhance global market presence by attracting new business and foreign investments.

FTZs are usually housed near a nation's ports of entry. For convenience reasons, areas with a close location to seaports and airports are generally designated as FTZs. However, in some cases, FTZs are designated outside these usual areas to cater to a specific industry or any other trade purpose. For instance, in the U.S., free trade subzones are provided as single-purpose sites for business operations involving oil refineries or other large manufacturing activities as otherwise it is difficult to upend such complex infrastructure to a location closer to sea or airports.

A feature of FTZs is that though located inside the geographic boundaries of a nation, they are usually declared as external to the laws of the nation in terms of customs purposes

A key feature of FTZs is that while such areas are located inside the geographic boundaries of a nation, it is usually declared as external to the laws of the nation in terms of customs purposes. Thus, components can be shipped into a FTZ, without concern for usual international trade arbiters or barriers such as quotas, tariffs, complex customs procedures, etc. Only after the processed good exits the zone ecosystem are quotas, tariffs, customs, etc, applicable. FTZs are often times given multiple terminologies across different parts of the world. In the U.S., they are referred to as foreign-trade zones; while they are known as special economic zones in China. In the GCC, and particularly in the UAE, the term FTZs is preferred.

Figure 1: Geographic Distribution of FTZs and Number of Employees, Global



[3] The U.S. Small Business Administration
[4] Ibid.

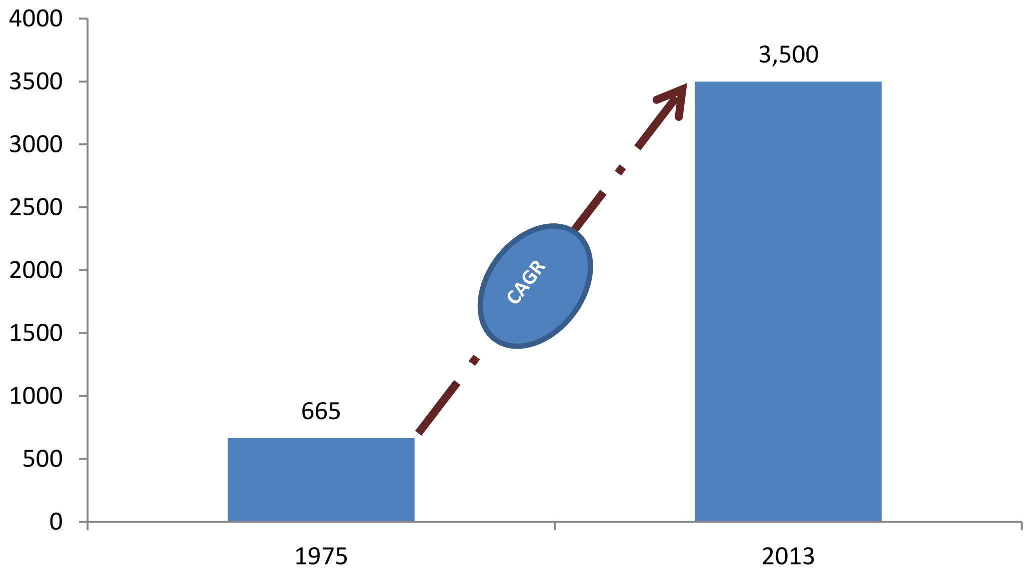
Numerical Marker from above figure	Country	Number of employees
1	China	40,000,000
2	Other Asia	14,741,000
3	Mexico and Central America	5,252,000
4	Middle East and North Africa	1,687,000
5	Transition Economies in Central and Eastern Europe	1,400,000
6	Sub-Saharan Africa	860,000
7	Caribbean	547,000
8	South America	460,000
9	United States	320,000
10	Western Europe	219,000
11	Indian Ocean	183,000
12	Pacific	146,000
	Total	65,835,000

Source: ILO Database on Export Processing Zones (Revised), by Jean-Pierre Singa Boyenge, Working Paper 251, 2007 quoted in Congressional Research Service, 2013

FTZs are generally associated with value addition or assembly, rather than integrated and technologically proficient manufacturing

It is notable from the above figures that the U.S. and Western Europe rank low down the scale in terms of hosting FTZ zones. This is due to the fact that FTZs are generally associated with value addition or assembly, rather than integrated and technologically proficient manufacturing. FTZs require some level of expertise for assembly, specific value addition and light manufacturing. However, the U.S. and Western Europe are proficient in manufacturing technology and thus are high up the scale in terms of having to depend on FTZs for generating revenue. Moreover, these regions tend to not see FTZs as a preferred method of jobs creation that the majority of the citizens would be attracted to. The following figure shows that FTZs have enjoyed a healthy level of uptake throughout the world over the past few decades.

Figure 2: Growth in number of FTZs, worldwide, 1975-2013



Source: ITP Business Publishing Ltd.

FTZs: Their economic role

FTZs' main economic draw is that they provide special incentives to attract foreign investors

In order to understand and dissect the economic role of FTZs, it is necessary to distill their use to their core purpose. FTZs' main economic draw is that they provide special incentives to attract foreign investors, in order for them to participate in a process by which imported materials undergo some level of processing before being exported or re-exported again from the zones[5]. The key benefits that governments seek through the promotion of FTZs are as follows[6] –

- **Attracting FDI:** FTZs help in the process of attracting FDI, which helps in increasing the level of capital stock of the host country.

- **Income generation and employment creation:** Experts argue that FTZz can lead to increased urbanization, and can provoke a shift towards manufacturing. Over time, the manufacturing capability is expected to yield capabilities to produce quality products, thus increasing the chances for export revenues. In the process, multiple employment opportunities are created, as well.

- **Technological transfer and knowledge expansion:** FTZs can help in the cause of technological transfer and knowledge expansion, thus bringing in crucial technological expertise and opportunities for skills enhancement into a country.

Though the benefits of FTZs are high in theory, it can be stymied if the focus is largely on "low value-added sectors with a high coefficient of unskilled labour"[7]. It should be noted that the concept of FTZs has been through several stages of evolution and is expected to continue in that vein, going forward. In the early stages of FTZs or the traditional concept, these zones were purely about export promotion, with little or no thought given to forward or backward linkages to the local economy[8]. In essence, FTZs were tightly fenced-in physical enclaves, which were often located in remote areas in order to satisfy political needs[9]. Since FTZs are usually covered by special and distinct customs rules and are placed under tight physical control in terms of goods movement to and fro, FTZs were tended to be seen as parallel economic arrangements within a country. However, FTZs have undergone a paradigm shift, too, as the forces of globalization and exponentially increasing global trade flows disrupt prior thought patterns.

The harmonization of common regulatory standards is another significant advantage

One of the biggest promises of FTZs is that they can lead to increased public welfare due to reduction of costs of doing trade[10]. The harmonization of common regulatory standards is another significant advantage that is propounded by experts in the field. For instance, the Transatlantic Trade and Investment Partnership (TTIP), which is currently being negotiated between the U.S. and the EU, sees common regulatory standards as one of the most ambitious objectives of the deliberations[11].

[5] International Labour Organization
[6] Deloitte
[7] OECD
[8] U.S. Agency for International Development
[9] Ibid.
[10] Bertelsmann Stiftung
[11] The Local Europe GmbH

The economic benefits of FTZs to governments and societies that host them are difficult to measure in a direct form, though the number of jobs they provide and the increase in private consumption in the areas surrounding FTZs can be taken as reasonable proxies. The greatest promise of economic benefits to governments that host FTZs is that in the promotion of free flow of international trade through FTZs would bring greater cost efficiencies and sharing of expertise more liberally, giving rise to many opportunities for national development projects such as skills development for citizens, innovation and reform environments and better prowess in learning best practices from the rest of the world in areas such as manufacturing and management. Thus, usually the benefits to a country from FTZs are classified into direct benefits and indirect benefits. The following table lists them –

Table 1: Benefits Derived from FTZs for the National Economy

Direct Benefits	Indirect Benefits
Foreign Exchange earnings	Skills upgrading
FDI	Testing field for wider economic reform
Employment generation	Technology transfer
Government revenue	Demonstration effect
Export growth	Export diversification
	Enhancing trade efficiency of domestic firms

Source: World Bank

FTZs and the GCC

There are totally 50 FTZs in the GCC, with the KSA having no duty-free import zones or free ports

In the GCC, FTZs can come under three forms[12] –

- **Free zones:** This covers the spectrum from free ports to export processing zones. They are structured in such a way as to be easily accessible to investors, but do not traverse the extent of offering a bespoke regulatory environment. E.g., Jebel Ali Free Zone (Jafza), the UAE. Jafza is located adjacent to the Jebel Ali port, one of the world's fastest growing ports. Around 150 shipping lines operate through the Jebel Ali port, counting about 14.5 million containers, per annum. Also, Jafza, is extremely close to the Dubai International Airport, which can handle about 2.7 million metric tons per annum.

- **Special economic zones (SEZs):** SEZs can be termed as ring-fenced areas that are free from customs and have a customized regulatory environment. Generally, they are backed by legislation that establishes a governing council and with a set of rules that shall apply to investors operating within the zone. E.g., Duqm SEZ, Oman. The SEZ is administered, regulated and developed by the Duqm Special Economic Zone Authority, which is a financially and administratively independent government entity.

In the KSA, the upcoming 'Economic Cities' can be considered as part of free zones of the future

- **Industry zones (IZs):** IZs are essentially free zones, but focused upon specific sectors. IZs may restrict entry of companies from non-priority sectors. Moreover, the infrastructure of IZs is usually tailored for specific sectorial requirements. E.g., Dubai Media City (the UAE). Started in 2001, this zone is focused on providing facilities to regional and global media companies. Some of the users of the zone include CNN, Reuters, CNBC, etc.

There are totally 50 FTZs in the GCC, with the KSA having no duty-free import zones or free ports[13]. In the KSA, the upcoming 'Economic Cities' can be considered as part of free zones of the future. However, there are indications that free trade zones are being considered in the KSA[14]. The split of the 49 FTZs in the GCC region across the various countries are given in the following table below –

Table 2: Split of FTZs Count in the GCC, 2014

Country	Number of FTZs
UAE	42
KSA	4*
Oman	3
Bahrain	3
Kuwait	1
Qatar	1

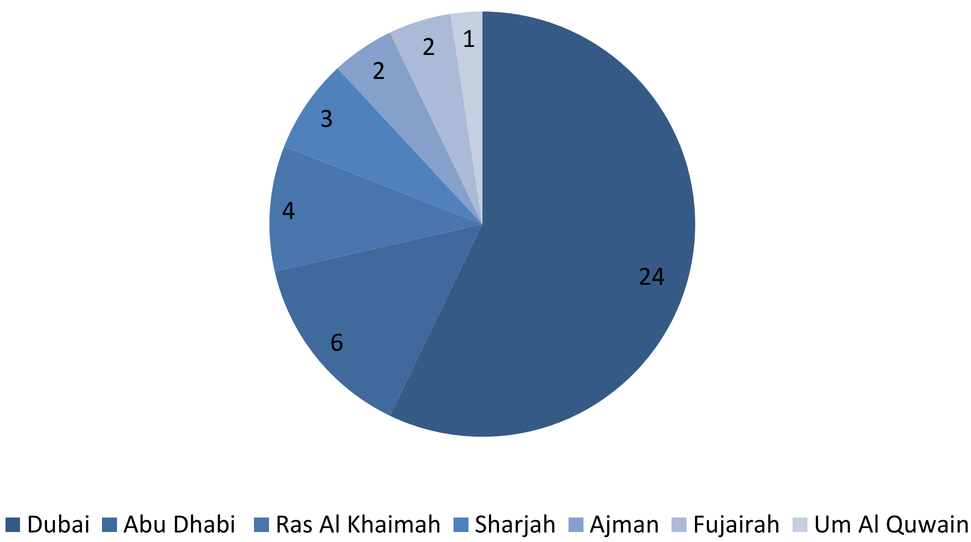
Source: World Bank, *- in KSA, the areas are considered as economic cities rather than FTZs.

[12] OECD
[13] European Commission
[14] Jebel Ali Free Zone Area

The free zone at Jebel Ali, a deep port in Dubai, is widely considered to rank among the most successful in the world

The first free trade zone, in the region,was the Jebel Ali Free Zone (JAFZA) in 1985 in the UAE[15]. There are totally 42 free zones in the UAE, which contain over 35,000 companies. The following table lists the number of free zones in the various Emirates of the UAE.

Figure 3: Number of Free Zones in the UAE by various Emirates



Source: Morison Menon

The free zone at Jebel Ali, a deep port in Dubai, is widely considered to rank among the most successful in the world. It originated as a trans-shipment port where large vessels and ships unloaded goods that smaller or feeder ships would transport to other ports around the Gulf area[16]. Jebel Ali activated a slew of free zone type initiatives, leading to the UAE accounting for over a third of the free zones in the MENA region. Over the years, the UAE has successfully, also, refined the programme of establishing industrial zones targeting specific sectors. The Dubai Media City is one good example.

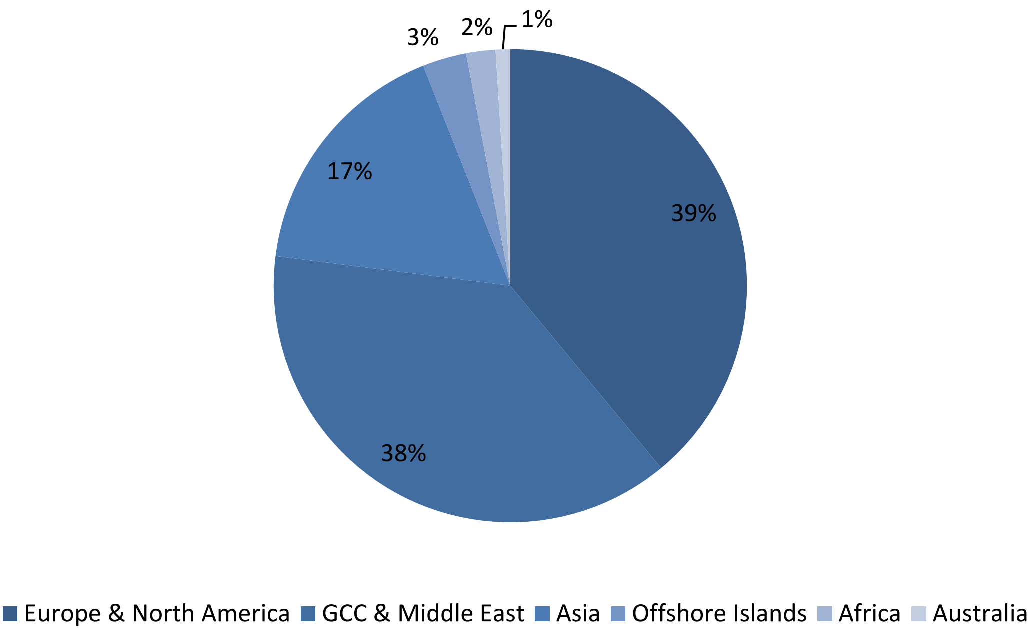
As of 2013, the total number of clients that DAFZA listed was over 1,600

The Dubai Airport Freezone (DAFZA) is considered a very successful free zone in the UAE and around the world. It was named as fDi magazine's Middle East Free Zone of the Future 2013/14. It reported a 42% increase in 2013 revenue, in comparison with 2012. As of 2013, the total number of clients that DAFZA listed was over 1,600[17]. The following figure provides the geographical split of the clients hosted by DAFZA.

[15] Dubai Free Zone Council
[16] OECD Observer
[17] Arabian Business Publishing Ltd

Figure 4: Geographical Split of Clients in DAFZA, 2013

In the GCC region, the UAE is considered to be a dominant success story in terms of accelerating FDI through FTZ



Source: DAFZA

In the GCC region, the UAE is considered to be a dominant success story in terms of accelerating FDI through FTZs. Over the years, the UAE has transformed itself into a logistics powerhouse, thus allowing companies in its FTZs to increase their international and regional reach[18]. Though JAFZA is a profound success, with many other FTZs trying to emulate it in the region, its success was built painstakingly and strategically over the years[19].

Over the years, the UAE has transformed itself into a logistics powerhouse, thus allowing companies in its FTZs to increase their international and regional reach

The UAE has been able to attract significant interest across its free trade zone paradigm due to the liberal, but strategic, incentives that the country offers to investors. There are financial incentives in terms of establishing manufacturing industries in the UAE[20]. They are mostly in the form of tax waivers and duty-free settings on profits and/or production. Some of the key incentives offered by the UAE FTZs are as follows[21] –

- 100% foreign ownership with 100% repatriation of capital and profits
- No corporate taxes for 50 years
- No personal income taxes
- Exemptions from customs duties
- Absence of currency restrictions

Since in the UAE, there are a number of FTZs, it becomes a difficult task to analyse every FTZ in detail. A ranking in terms of leading FTZs in the Middle East would help in that regard. The following ranking from fDi Intelligence[22] is provided in that direction.

[18] ITP Business Publishing Ltd.
[19] Ibid.
[20] Grant Thornton UAE
[21] Ibid. (Verbatim)
[22] A specialist division from The FT Ltd.

In Kuwait, the country has only one FTZ, called the Kuwait Free Trade Zone

Table 3: Top 25 Middle East Free Zones of the Future, 2013/14 Ranking

Rank	Economic Zone	Country
1	Dubai Airport Freezone	UAE (Dubai)
2	Jebel Ali Free Zone	UAE (Dubai)
3	Dubai International Financial Centre	UAE (Dubai)
4	Jumeirah Lakes Towers Free Zone	UAE (Dubai)
5	Salalah Free Zone	Oman

Source: fDi Intelligence

In Kuwait, the country has only one FTZ, called the Kuwait Free Trade Zone[23]. It is located at Shuwaikh port, the nation's principal commercial shipping facility. The zone was inaugurated in 1999[24]. The FTZ was established by the private player, National Real Estate Company[25]. The FTZ is still managed by private interests. There is not much information available publicly about the FTZ in Kuwait.

Unlike the UAE, the Kingdom of Saudi Arabia (KSA) has been relatively less quick in adopting the concept of the FTZs. One of the key reasons is the accession of the KSA to the World Trade Organisation (WTO), which took place in December 2005, only[26]. In comparison, the UAE had acceded to the WTO in April 1996[27]. When the KSA did start looking seriously at setting up free zones, the policy planners decided that the existing models of just special economic zones, processing zones, etc, alone, would not suit the country's economic diversification requirements[28]. Thus, the model of the 'Economic Cities' was construed, positioned as a new business model that would allow nationals and skilled expatriates to function in a 'work, play and live' environment[29]. Moreover, the KSA Economic Cities place an emphasis on a simulator type environment for testing policy efforts to economically diversify the country. There are four economic cities in the KSA, which are envisaged for completion by around 2030[30]. They are –

The KSA Economic Cities place an emphasis on a simulator type environment for testing policy efforts to economically diversify the country.

- King Abdullah Economic City – Rabigh (near Jeddah)
- Prince Abdul Aziz bin Mousdaed Economic City – Hail
- Knowledge Economic City – close to Al Madinah
- Jazan Economic City – close to Jazan City

It is envisioned that these cities, after construction, will work on the lines of public-private partnerships in terms of creating attractive propositions for foreign companies to invest. Aimed at promoting economic diversification, they are expected to create a million new employment opportunities, provide housing for about 4-5 million of the Saudi population, and make a contribution of about $150 billion to the GDP of the nation, by 2020[31]. The following table summarizes the nature of the Economic Cities and the aspect of FTZ like features underpinning them –

[23] MEED
[24] Kuwait Investment and Business Guide, pg65
[25] OECD
[26] Asharq Al Awsat
[27] WTO
[28] Cadre Economic Cities
[29] Ibid.
[30] 'Doing Business in Saudi Arabia' guide
[31] Saudi Gazette

Oman is a relatively new entrant in the area of FTZs

In the GCC nation of Oman, there are vigorous plans afoot to reduce the dependence on oil revenues from around 50% of GDP, currently, to about 9% by 2020[32]. In order to realize this ambitious plan, focus is being riveted upon heavy industry, tourism and on a proactive workforce nationalization programme. Oman has FTZs at the following locations[33] –

- Sohar
- Salalah
- Duqm

A common feature is that all of the above FTZs are situated adjacent to sea ports. Also, various incentives are offered to investors, including free repatriation of capital and profits, 100% foreign ownership, nil currency restrictions and some exemptions on import and export duties. Oman is a relatively new entrant in the area of FTZs, with the nation's first FTZ at Salalah becoming operational in 2005, only[34]. In 2012, the relevant Omani authorities announced that an investment of $450 million would be made in expanding the free zones in the country. Measures include constructing warehouses; expanding land plots; building roads, offices and staff accommodation; and enlarging storage space. The economic zone in Duqm, which was declared in 2011, is touted as a model of integrated economic development. Multiple zones would constitute Duqm, including a sea port, residential township, industrial area, tourist zone, fishing harbor, training and education zone, a logistics center; all of which will be linked together with a modern multimodal transport system. A point of note is that there is a free zone at Al Mazyona, close to the border with Yemen, which is largely used for trade with Yemen[35].

Like other GCC nations, the state of Bahrain is attempting to diversify its economy away from hydrocarbons, as well[36]. Bahrain has three FTZs or special economic zones, which are –

- The Bahrain Logistics Zone
- Bahrain International Airport
- Bahrain International Investment Park (BIIP)

Bahrain has three FTZs or special economic zones

Some of the key benefits offered by Bahraini FTZs are as follows –

- 100% foreign ownership of companies
- Duty-free access to GCC markets
- Waiving away of import duties on raw materials and equipment
- 100% repatriation of capital

Qatar, one of the fastest growing economies in the GCC, there is only one free trade zone[37]. The 45,000-square-metre zone, called Qatar Science and Technology Park (QSTP), focuses on the environmental sciences, energy, ICT and health sciences. Qatar is following a model of free zone that is focusing on high end applied research,

[32] MEED
[33] ProjectOman
[34] DownstreamToday.com
[35] Omanuna
[36] MEED
[37] MEED

involving robust educational inputs[38]. It is notable that QSTP hosts a number of international universities. Also, there is evidence of strong focus on developing an entrepreneurial culture through mentoring and training. The benefits that QSTP offers to external investors are as follows[39] –

- Operate as a local company, or operate as a branch of a foreign company
- 100% foreign ownership
- Hire expatriate employees
- No taxes
- Duty-free import of goods, equipment and tools into the free zone and services
- Unrestricted repatriation of capital and profits

Thus, a pattern emerges that every country in the GCC follows its own style of setting up FTZs, in line with larger national objectives.

[38] Qatar Science & Technology Park (QSTP)
[39] Ibid. (verbatim)

A Comparative Study of FTZ Characteristics in the GCC

Many authorities in the GCC are looking at free zones as not simple tax free areas, but as high quality knowledge and economic clusters

There is evidence that many authorities in the GCC are looking at free zones as not simple tax free areas, but as high quality knowledge and economic clusters that would spur innovation and tap new economic productivity potential. The imperative across GCC is to move away from the concept of traditional export processing to special purpose industrial and economic zones. The UAE's practice of clustering or grouping manufacturing facilities in sectors of high commercial and scientific value has proved to be a trendsetter[40]. For e.g., Dubai's Technology and Media Free Zone was set up in 2003 and within five years, hosted the regional offices of major broadcasting companies such as BBC, Reuters, etc[41]. It appears that Qatar is the one closely trying to stimulate this model, though with a tinge of quality educational refinement along with the commercial angle that Dubai (UAE) so clearly focuses upon. JAFZA (the UAE) alone has about 7,100 companies, including 800 American firms[42].

JAFZA enjoys a competitive advantage of excellent geographical capabilities, supportive policies and a visionary leadership in terms of support from the government. The sea-air-land strength of JAFZA is sketched in some detail by the following table.

Table 4: JAFZA, Sea-Air-Land Multimodality Strength

Sea	Air	Land
Co-located with the world's largest human-made port	Very close to Dubai International Airport	Supported by a Dubai road network of 16,800 km
Capacity to handle 15 million containers, annually	Capacity to handle 2.7 million metric tons	Very high quality roads
Serviced by over 170 shipping lines	Adjacent to the new Al Maktoum Airport, which is expected to emerge as one of the largest cargo airports in the world	Road network supported by constantly growing Metro network
	Single, customs bonded corridor connectivity from Jebel Ali Port to the Al Maktoum Airport	Metro network currently covers 75 km of track

Source: Jafza

Effective multimodal support is a key enabler for FTZs

Thus, one of the key success points required is effective multimodal support, in light of the lesson emanating from JAFZA. Other free zones in the region are quickly picking up the lesson. For instance, the Sohar Free Zone in Oman will be worked upon in five phases, complete with plans for a new rail system and an international airport[43]. Situated close to the UAE border, the Sohar zone has so far received about $14 billion of Omani government investment in the financing of multiple industrial projects. Also,

[40] OECD
[41] Strategy& (Formerly Booz & Company)
[42] Jafza
[43] Intec Export Intelligence Limited

The free zone in Kuwait has not been able to attain the desired level of investor interest

the Sohar Industrial Port Company (SIPC), a 50-50 joint venture of the Government of Oman and the Port of Rotterdam (Netherlands), has a concession for developing, operating and managing a 4,500 hectare free zone close to the industrial port.

The subject of effective transport modalities is receiving strong attention. Recent evidence is the Duqm zone, again in Oman, for which works are afoot to link it to the 2,244km national railway network. This link will in turn be connected to the GCC rail system[44]. Compared to some of the successful zones in the UAE and even Oman, the free zone in Kuwait has not been able to attain the desired level of investor interest. Culling lessons from the successes across UAE and Oman, a list can be simulated in terms of the common factors that inhibit the success of a zone[45] –

- Poor site selection, causing overshoot in projected capital expenditures
- Policies that are uncompetitive in terms of tax holidays, labor practices and rigid performance stipulations
- Weak zone development practices, i.e., ill-designed or over engineered facilities. Also, lack of adequate maintenance and poor promotion or marketing efforts will hinder cultivation of investor interest
- Highly subsidized rent and other essential services, which drives down financial profitability and viability in terms of offsetting benefits of incoming foreign investments
- Wearisome procedures, customs and red tape
- Lack of appropriate administrative oversight or an overkill in terms of supervisory bodies
- Low level of cooperation and trust between private and public sector partners

The use of generous incentives to offset key disadvantages in location and management is pointed out as ineffective by experts in the field

The success or failure of a zone is closely linked to the policy and incentive framework, strategic nature of the location, development and management efficiency. The use of generous incentives to offset key disadvantages in location and management is pointed out as ineffective by experts in the field. Also, there is a growing consensus that trade or economic zones should not be seen as a substitute for a nation's overall trade and investment reform strategy and efforts. Zones are only one tool in an array of mechanisms in terms of creating jobs, generating exports and improving levels of foreign investment. Probably, the success of the economic zones in Dubai lies in how seamlessly it is integrated with the overall national strategy of turning into a commercial and manufacturing hub, in terms of serving regional and global stakeholders.

[44] Oman Daily Observer
[45] The World Bank Group

The Reasons behind UAE FTZs' Success

Close to 85% of the FTZs in the GCC region are based out of the UAE

Since close to 85% of the FTZs in the GCC region are based out of the UAE, the study of the UAE's FTZ's ecosystem becomes necessary as to why the nation, particularly Dubai, has been able to build a highly efficient system. The system is known for its efficiency, worldwide, while many other GCC countries try to replicate the success.

While many parts of the world are still recovering from the economic crisis of 2008, the FTZs in the UAE have only kept growing. For instance, in 2013, 2,900 new companies registered with the FTZ of Ras Al Khaimah (RAK), which is an increase of 30% over the previous year[46]. One of the key reasons of the success of RAK is the low levels of capital requirement (Dh103,000 as of 2011) needed to start a business[47]. RAK specializes in the SMEs area. The costs are kept low as the FTZ provides them with sharing of costs through the shared services model.

A trait that many of the FTZs in the UAE have displayed is the ability to seize opportunities when they are presented, even during times of adversity. For instance, around October 2009, when the impact of the financial crisis was working its way to the peak in many parts of the world, including UAE, the Hamriyah Free Zone in Sharjah announced a boost to its marketing budget by 20%[48]. The counterintuitive strategy was adopted as a means of sending out the message that the UAE was one of the few places in the world that was still garnering investor interest despite the devastating impact and fear that the financial crisis was generating. Ultra-cheap office space was put on offer (even as low as $5,000) in order to entice clients, which demonstrated flexible thinking in difficult times[49].

It is notable that 1/3rd of the global population are within just four hours of flying time from Dubai

The UAE definitely has location-specific advantage, a factor that feeds into the success of the FTZs. For instance, Dubai airport is on an average within eight hours flying time of most major world destinations, covering about two-thirds of the global population[50]. It is notable that 1/3rd of the global population are within just four hours of flying time from Dubai. But location specific advantage is not singular to the UAE in the GCC region. UAE's success with FTZs in relation with other GCC countries is largely put down to its pioneering efforts in the area[51]. The pioneering interest that the UAE leadership displayed gave the country the first-mover advantage over peers in the region, given the fact FTZs typically require long incubation periods[52].

Revolutionary reforms of domestic environment have been one of the hallmarks of FTZs success in the UAE. If the UAE (particularly Dubai) seems an astounding success in terms of FTZs, that success is a product of years of continuous reforms that have often been punctuated with sudden leaps. For instance, Dubai International Financial Centre (DIFC), a financial free zone, through decree in 2004, was allowed to establish its own legal and regulatory framework for civil and commercial matters[53]. English

[46] RAK FTZ
[47] Abu Dhabi Media
[48] Ibid.
[49] Ibid.
[50] Dubai Airports
[51] Abu Dhabi Media
[52] Ibid.
[53] DIFC LCIA Arbitration Centre

common law, which is held in trust in many key parts of the world, is used in the DIFC, which has raised the level of confidence for investors[54].

The early urgency and foresight that the UAE displayed in terms of economic diversification can be highlighted as the spur behind the push for FTZs

The voluntary withdrawal of national laws in favor of the laws of another country across the FTZ has sent out the clear message that the focus in on efficiency and enabling international ease of doing business. Thus, investors and businesses are confident in terms of aligning behind and trusting the government's commitment to supporting economic growth through FTZs. Apart from an independent legal framework, the DIFC is under an independent regulatory governance framework that operates under the Dubai Financial Services Authority (DFSA)[55]. The European Commission, in August 2013, formally announced the DFSA's audit controls to be of "equivalent status" with those of the Eurozone. Following the declaration, DIFC was able to seal an agreement with the European Securities and Markets Authority, under which companies in the DIFC will be able to market alternative investment vehicles, such as hedge funds and private equity, to European investors.

The early urgency and foresight that the UAE displayed in terms of economic diversification can be highlighted as the spur behind the push for FTZs in the country at a time much before other GCC countries took and applied the concept seriously and strategically. The FTZs of the UAE have proved very successful in attracting FDI and technological expertise, thus providing a robust foundation for a non-oil economy and making the UAE a key center for global commerce and re-exports[56]. Even within the UAE, the emirates of Dubai and Sharjah have enjoyed more success in FTZs, which other emirates within the country are trying to emulate.

UAE seems to consciously follow the approach and strategy of fostering economic development through adoption and building on concepts that may not produce immediate results, but are set to dictate the way global commerce is going to move in the future. Masdar City, dual free zone and investment location in the UAE, is consistently chipping away at making the location a green energy cluster[57]. Though Masdar's record is punctuated with remarks of lack of success in some assessments, the fact remains that the location has global companies such as Schneider Electric, Siemens, Mitsubishi Heavy Industries, General Electric, Wrightbus International, etc, operating there[58]. There are 130 companies registered within Masdar City and the initiative will likely boost UAE's capacity to lead in the field of green technologies in the future[59]. Thus, the UAE's FTZ strategy is meticulously built on the logic that well run FTZs will bring in important FDI that will in turn ramp up technology and knowledge transfers, trade flows, job creation and increased opportunities for UAE businesses to directly or indirectly enjoy the fruits of an ecosphere of success[60].

The UAE's FTZ strategy is meticulously built on the logic that well run FTZs will bring in important FDI that will in turn ramp up technology and knowledge transfers

Experts point out that the fiscal incentives that are offered by several leading free zones in the UAE are the best in the world and that there is little scope of upward movement in terms of further incentives that the major zones can offer. In other words, they have gone to the maximum upper limit in terms of incentives. Even as

[54] Telegraph Media Group Limited
[55] Knowledge@Wharton
[56] QNB
[57] Guardian News and Media Limited
[58] Arabian Business Publishing Ltd
[59] Ibid.
[60] Abu Dhabi Media

one round of a model of growth is coming to a close, over the recent years, another round based on 'differentiated options' has begun in the UAE[61]. Zones based on industry clusters, similar to green energy of Masdar, have come up in high frequency over recent years. Examples include the Dubai Media City, Dubai Internet City and Dubai Healthcare City. SMEs from a singular sector are able to congregate together, thus bringing into play opportunities for intense collaboration and creative ventures. The ability of free zones in the UAE to connect people and competencies is emerging as the new competitive differentiation package, giving an edge over competitors, worldwide.

[61] HSBC

It is argued that there is a significant role that private enterprise can adopt in the development of zone infrastructure

The role of the private sector in the FTZs

The governments will have a dominant role in financing and oversight of FTZs/SEZs[62]. Yet, it is argued that there is a significant role that private enterprise can adopt in the development of zone infrastructure. What is called for is a realistic approach to zone development. Some areas of infrastructure development can pragmatically be handed over to the private sector (e.g., ports, telecommunications, etc). However, some critical ones, such as railways and oil rigs, will have to remain within the mandate of the government. There are two key reasons behind this[63] –

- The returns could be slow to generate on a particular infrastructural investment. Though slow in yielding returns, the development of that piece of infrastructure could be extremely crucial for the long term viability of the project (e.g., railway line link up with the national network). The private sector may display impatience

- Matters that could trigger political sensitivities, such as appropriation of land by private sector interests

The unsuccessful involvement of the private sector in terms of creating vibrant free zones is largely due to mismatch between the private sector objectives and government policy

Most often, the unsuccessful involvement of the private sector in terms of creating vibrant free zones is largely due to mismatch between the private sector objectives and government policy. Since the private sector player taking part in a SEZ is attracted mainly by the incentives, such as a relatively deregulated environment and special tariffs, the most smallest of inconveniences to private sector facilitation can bring out the disconnect in any pairing of conveniences. However, if governments and the private sector players can work a way towards effective cooperation, there are multiple benefits for the authorities. They are –

- The cost of development is reduced
- There is support to mitigate risks
- Private sector expertise can be tapped into
- Innovative structures and matters of technical know-how can be more easily ingested

Recent evidence shows that the development of free zones has undergone a profound shift in terms of involvement of the private sector. This is depicted in the following table, under the rubrics of 'Old Framework' and 'New Framework'[64].

[62] KPMG
[63] Ibid.
[64] US AID, TAPR II (Verbatim)

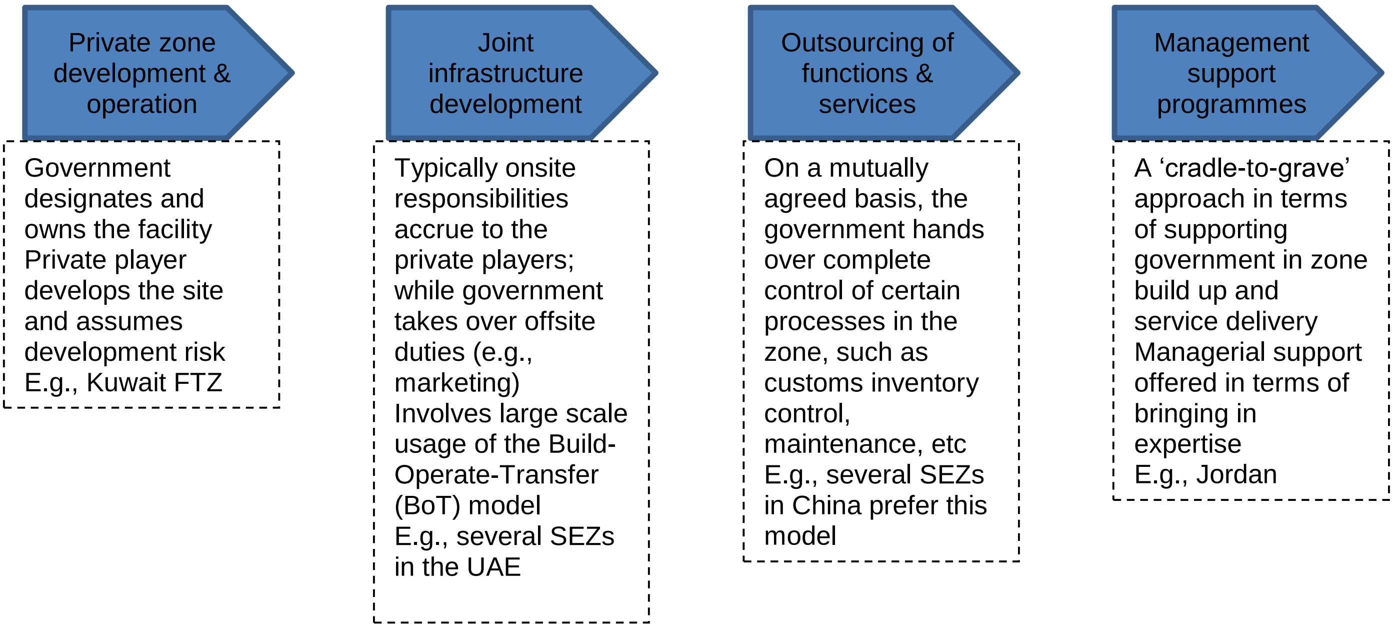
Table 5: The Paradigm Shift in the Involvement of the Private Sector in Zone Development

Old Framework	New Framework
Zone Authority would develop, own, operate and regulate the zone	Zone Authority only regulates activities within the zone
Zone Authority has little power over other government bodies	Private developer develops, owns and operates the zone on a cost-recovery basis
Zone funded by government; typically subsidized services & facilities	Outsourcing of core functions to private sector
Public sector development and operation of zones	Zone enterprise designation extended to developers and service intermediaries

Source: US AID

In terms of the involvement of the private sector, there could be a spectrum arc drawn depicting the greater level of impact.

Figure 5: The Spectrum of Private Sector Involvement in FTZs



Source: US AID, TAPR II

The overall trend is that there is increasing favor for more private sector involvement in SEZs

Potential policy pitfalls

There are some common pitfalls in terms of development of free zones

There are some common pitfalls in terms of development of free zones, which governments should take cognizance of. They are[65] –

- Elevated and excessive levels of bureaucracy involving various institutions in the nation, especially around customs and tariffs
- Extremely or unnecessarily long delays in terms of acquiring required permits and licenses
- Voracious demands made of potential investors in terms of jobs to be created, initial investment and quick demonstrations of viability
- Tight control over labour regulations
- Unpredictability in prices of factors of production. For e.g., will subsidization of energy continue or will a sudden policy stroke wipe away such monetary benefits?

Experts repeatedly point out that though advantages like tax privileges can lower the bar of investment barrier for foreign investors, such benefits alone will not be sufficient in terms of attracting overseas investors to invest. An ecosystem of stagnant innovation, difficulties in accessing a skilled workforce, low levels of R&D in technology, difficulties in obtaining finance and red tape, etc, can stifle the perceived advantages of free zones[66].

Emphasis on nominal bureaucratic collaboration will not produce any spectacular benefits for foreign investors, thus reducing the competitiveness of a particular SEZ

Also, for SEZs to be successful, multiple stakeholders in the country, including government agencies, research universities and the private sector should form a mammoth network of cooperation that is focused on business goals[67]. Emphasis on nominal bureaucratic collaboration will not produce any spectacular benefits for foreign investors, thus reducing the competitiveness of a particular SEZ. The following are the common problematic areas that hobble foreign investors in SEZs. Thus, a policy framework that removes or minimizes these obstacles would have done well in terms of avoiding multiple pitfalls[68] –

- Vague regulations or legal barriers in terms of taking full advantage of regulatory benefits like low or nil taxation (i.e., the latent contractual clauses in 'small print')
- Poorly developed infrastructure
- Additional hidden costs (e.g., for usage of cranes, etc)
- Shortage of skilled labour
- No network or business collaboration with academia and R&D institutions
- Difficulties or frictions in dealings with government and SEZ management
- Limited scope for business expansion or misrepresentation of the real size of opportunities
- Problems in accessing innovatively structured financing

[65] Ministry of Trade and Industry, Republic of Rwanda
[66] Turku School of Economics, Finland
[67] Ibid.
[68] KPMG

Conclusions and Policy Recommendations

The best practices in terms of zone development can be broadly classed into six themes, which intertwine each other in terms of offering combined competencies. They are[69] –

- Selecting the appropriate zone Type
- Identifying physical development and management priorities
- Creating the suitable policy framework
- Formulating a strategic incentive framework
- Setting up a robust regulatory framework
- Providing a supporting institutional framework

The following table presents recommendations under each of the above themes.

Table 6: Policy Recommendations

Theme	Recommendations
Selecting the appropriate zone Type	• Develop firm clarity on what sort of a free zone is desirable for the particular needs and characteristics of the nation. ➢ For e.g., would an export processing zone serve the immediate requirements over an industrial cluster, etc? • Determine early on the level of private sector involvement in order to drive smooth operability in the more demanding phases of project execution • Do not ape the free zone models of other nations just because they have been successful. Each nation has its unique characteristics, strengths and weaknesses. Capitalize on strengths
Identifying physical development and management priorities	• Have a clear set of strategic criteria in terms of selecting a location base for a free zone • Focus on operational and cost aspects such as multimodality • Use innovative land planning and zoning efforts in concert with the private sector in order to spread risks • Base management methodologies on cost-recovery and customer focus principles
Creating the suitable policy framework	• Be pragmatic in terms of setting expectations for investors. Do not give in to the tendency of over demanding • Have a robust cost-benefit analysis in place in terms of being able to visualize multiple management and operational scenarios (e.g., level of input from the private sector can be adjusted, accordingly) • Have workable labour policies, at least in the medium term, in order to allow development of a critical mass of viability for the zone • Actively seek out ways in terms of what policy support can allow domestic SMEs to participate and benefit from a free zone ecosphere • Develop appropriate policy vehicles in order to increase cooperation between the zone and R&D institutions in the country

[69] OECD

Formulating a strategic incentive framework	• Develop well-crafted policies that focus on encouraging capital formation rather than incentivizing tax planning on the part of investors • Monitor and evaluate policies on incentives and subsidies in order to constantly refine what is working and for weeding out counterproductive elements • Plug loopholes that may allow investors to abuse the system in terms of taking monetary advantage or consuming subsidies in an unacceptably self-serving manner • Develop appropriate exit clauses in order to smooth the process for all stakeholders. Investors would appreciate a forward looking plan that covers all eventualities
Setting up a robust regulatory framework	• Simplify and make efficient the investment approval regime. Cut red tape and influence of corruption as far as possible • Enforce regulations as declared, in order to create trust among future investors
Providing a supporting institutional framework	• Sufficient autonomy to be provided to the zone authorities in terms of critical operational areas • Effective corporate governance mechanisms should be in place (e.g., an independent board) • Clever usage of the private sector through strategies such as outsourcing in terms of non-core activities and services

Source: Marmore

Appendix

Table 1: Types of Zones

Type of Zone	Development Objective	Physical Configuration	Typical Location	Eligible Activities	Markets	Examples
Free Trade Zone (Commercial Free Zone)	Support trade	Size < 50 hectares	Ports of entry	Entrepot and trade-related activities	Domestic, re-export	Colon Free Zone, Panama
Traditional EPZ	Export manufacturing	Size < 100 hectares; total area is designated as an EPZ	None	Manufacturing, other processing	Mostly export	Karachi EPZ, Pakistan
Hybrid EPZ	Export manufacturing	Size < 100 hectares; only part of the area is designated as an EPZ	None	Manufacturing, other processing	Export and domestic market	Lat Krabang Industrial Estate, Thailand
Freeport	Integrated development	Size > 100 km^2	None	Multi-use	Domestic, internal and export markets	Aqaba Special Economic Zone, Jordan
Enterprise Zone, Empowerment, Urban Free Zones	Urban revitalization	Size < 50 hectares	Distressed urban or rural areas	Multi-use	Domestic	Empowerment Zone, Chicago
Single Factory EPZ	Export manufacturing	Designation for individual enterprises	Countrywide	Manufacturing, other processing	Export market	Mauritius Mexico Madagascar

Source: The World Bank Group (Verbatim)

Table 2: Examples of Specialized Zones

Type of Zone	Development Objective	Size	Typical Location	Activities	Markets	Examples
Technology or Science Parks	Promote high tech and science-based industries	< 50 hectares	Adjacent to universities, institutes	High technology activities	Domestic and export	Singapore Science Park, Singapore
Petrochemical Zones	Promote energy industries	100-300 hectares	Petrochemical hubs; efficient energy sources	Petrochemicals and other heavy industry	Domestic and export	Laem Chabang Industrial Estate, Thailand
Financial Services	Development of off-shore financial services	< 50 hectares	None	Offshore financial and non-financial services	Export	Labuan Offshore Financial Centre, Malaysia
Software and Internet	Development of software and IT services	< 20 hectares	Adjacent to universities, urban areas	Software and other IT services	Export	Dubai Internet City, United Arab Emirares
Airport-based	Air cargo trade and transshipment	< 20 hectares	Airports	Warehousing, transshipment	Re-export and domestic	Kuala Lumpur Airport Free Zone, Malaysia
Tourism	Integrated tourism development	200-1,000 hectares	Tourism areas	Resorts and other tourism	Export and domestic	Baru Island, Colombia
Logistics Parks or Cargo Villages	Support logistics	< 50 hectares	Airports, ports, transport hubs	Warehousing, transshipment	Re-export	D1 Logistics Park, Czech Republic

Source: The World Bank Group (Verbatim)

Table 3: Top 25 Middle East Free Zones of the Future, 2013/14 Ranking

Rank	Economic Zone	Country
1	Dubai Airport Freezone	UAE (Dubai)
2	Jebel Ali Free Zone	UAE (Dubai)
3	Dubai International Financial Centre	UAE (Dubai)
4	Jumeirah Lakes Towers Free Zone	UAE (Dubai)
5	Salalah Free Zone	Oman
6	Bahrain International Investment Park	Bahrain
7	Ras Al Khaimah Free Trade Zone	UAE (Ras Al Khaimah)
8	Rakia Economic Zone	UAE (Ras Al Khaimah)
9	Aqaba Special Economic Zone	Jordan
10	Aqaba International Industrial Estate	Jordan
11	twofour54, Media Zone	UAE (Abu Dhabi)
12	Ajman Free Zone	UAE (Ajman)
13	Dubai Media City	UAE (Dubai)
14	Freezone Sohar	Oman
15	Dubai Silicon Oasis	UAE (Dubai)
16	Tanger Free Zone	Morocco
17	Bahrain International Airport	Bahrain
18	Bahrain Logistics Zone	Bahrain
19	Dead Sea Development Zone	Jordan
20	Dubai Knowledge Village	UAE (Dubai)
21	Dubai Healthcare City	UAE (Dubai)
22	Dubai Biotechnology and Research Park	UAE (Dubai)
23	Dubai International Academic City	UAE (Dubai)
24	Dubai Studio City	UAE (Dubai)
25	Khalifa Bin Salman Port	Bahrain

Source: fDi Intelligence

Table 4: Economic Cities in the KSA

Economic City	Summarized Description
King Abdullah Economic City (KAEC), Rabigh	• Located north of Jeddah • Focus on logistics and ports industries • Is envisaged to feature a high quality seaport, a residential and an education zone, an industrial and a financial district, and tourist attractions • Area of 168 million square meters
Prince Abdul Aziz bin Mousdaed Economic City (PABMEC), Hail	• Focus on agribusiness, logistics, minerals and construction products • Being developed as a city specializing in industry and manufacturing • Ambitions of creating 55,000 new jobs • Area of 156 million square meters
Knowledge Economic City (KEC), Madinah	• Focus on knowledge-based industries (medical sciences, biotechnology, etc) and domestic tourism • Expected to create 20,000 new jobs • Area of 4.8 million square meters
Jazan Economic City (JEC), Jazan	• Being designed as a fully-fledged agribusiness hub • Situated in the nation's South-Western region on the Red Sea • Also, will blend traditional heavy industry • Planned to create half a million jobs in the nation • Area of 100 million square meters

Source: Saudi Gazette, SUSRIS

Table 5: Underlying Principles of the Economic Cities in the KSA

Principles	Description
Instilling competitive advantage	• Development around at least one competitive cluster, in terms of possessing global capabilities • Cluster to serve as a pivoting anchor and as a growth impetus or engine for the city
Quality 'hard' and 'soft' infrastructure	• Greenfield opportunity to be utilized in terms of adopting state-of-the-art modern urban technological solutions (e.g., smart cities)
Generating opportunities for the private sector	• Robust investment opportunities for the private sector in real estate, infrastructure and industry
Creating knowledge workers	• By allowing development of quality manufacturing, research and services companies, an ecosystem for employing knowledge workers will be created. • An ecosystem of knowledge workers will give rise to a secondary stream of employment in terms of support services
Attracting people	• An atmosphere that would allow for a quality lifestyle in order to attract diverse sets of people to contribute to the growth of the KSA
Business friendly systems	• Helpful or friendly regulatory environment that allows ease in pouring in of investment • Regulations aimed at being competitive enough to stand against other FTZs, globally

Source: SAGIA

Table 6: Major Industries targeted across Omani FTZs

FTZ	Industries Targeted/Serviced
Salalah	• General trading license: import, export, distribution and storage • Trade license: import • export, distribution and storage of specific items • Industrial license: manufacturing, import of raw materials and export of finished products • Service license: completion of specified services
Sohar	• Marble • Food • Detergents • Household goods • Leather • Furniture • Resins • Glass • Steel bars • Engine oil
Duqm	• Industrial estates • Warehousing and logistics villages • Tourist villages and resorts • Commercial, office and residential complexes

Source: MEED

Table 7: Major Industries targeted across Bahraini FTZs

FTZ	Industries Targeted/Serviced
Bahrain Logistics Zone	• Third-party logistics • Storage and distribution • Logistics services and value-added logistics services, including assembly, packaging and re-packaging
Bahrain International Airport	• Cargo facilities • Retail • Advertising space • Offices
Bahrain International Investment Park	• Manufacturing • International services

Source: MEED

Table 8: Top 50 Free Zones of the Future 2012/13: Global

Rank	Name of Zone	Country
1	Dubai Airport Free Zone	UAE
2	Dubai International Financial Centre	UAE
3	Shanghai Waigaoqiao Free Trade Zone	China
4	Iskandar	Malaysia
5	DuBiotech	UAE
6	Tanger Free Zone	Morocco
7	Freeport of Ventspils	Latvia
8	The Clark Freeport Zone	Philippines
9	Chittagong Export Processing Zone	Bangladesh
10	Dubai Media City	UAE
11	JLT Freezone	UAE
12	Katowice Special Economic Zone	Poland
13	Dubai Silicon Oasis	UAE
14	Mauritius Freeport	Mauritius
15	Bahrain International Investment Park	Bahrain
16	Khalifa Bin Salman Port	Bahrain
17	Salalah Free Zone	Oman
18	Lodz Special Economic Zone	Poland
19	Bahrain International Airport	Bahrain
20	Aqaba Special Economic Zone	Jordan
21	Twofour54 (Media Zone Authority, Abu Dhabi)	UAE
22	Walbrzych Special Economic Zone	Poland
23	Dubai International Academic City	UAE
24	Dubai Healthcare City	UAE
25	Rakia Economic Zone	UAE
26	Dahej Special Economic Zone	India
27	Dubai Studio City	UAE
28	El Paso International Airport	US
29	Dubai Knowledge Village	UAE
30	Bahrain Logistics Zone	Bahrain
31	Ras Al Khaimah Free Trade Zone	UAE
32	Montreal Port	Canada
33	Aqaba International Industrial Estate	Jordan
34	Astana New City Special Economic Zone	Kazakhstan
35	Pomeranian Special Economic Zone	Poland
36	Klaipeda Free Economic Zone	Lithuania
37	Starachowice Special Economic Zone	Poland
38	Sheffield City Region Enterprise Zone	UK
39	Industrial Free Zone – Togo	Togo
40	SEZ Alabuga	Russia
41	Free Zone Pirot	Serbia
42	International Media Production Zone	UAE
43	Zagreb Free Zone	Croatia

44	Dead Sea Development Zone & Jabal Ajloun Development Zone	Jordan
45	6th of October City	Egypt
46	Birmingham City Centre Enterprise Zone	UK
47	Technological Industrial Development Zone Skopje 1 & 2	Macedonia
48	Southeast-Ecka, Zrenjanin	Serbia
49	Freeport of Riga	Latvia
50	Rezekne Special Economic Zone Authority	Latvial

Source: fDi Magazine

Table 9: Top 10 Middle East Free Zones of the Future 2011/12: Best Economic Potential

Rank	Name of Zone	Country
1	Jebel Ali Free Zone	UAE
2	Aqaba Special Economic Zone	Jordan
3	RAK Free Trade Zone	UAE
4	(KAEC) King Abdullah Economic City	KSA
5	RAKIA Industrial Park	UAE
6	Tangier Exportation Free Zone	Morocco
7	KADDB Industrial Park	Jordan
8	Dubai Airport Free Zone	UAE
9	Khalifa Industrial Zone	UAE
10	Dubai World Central Logistics City	UAE

Source: fDi Magazine

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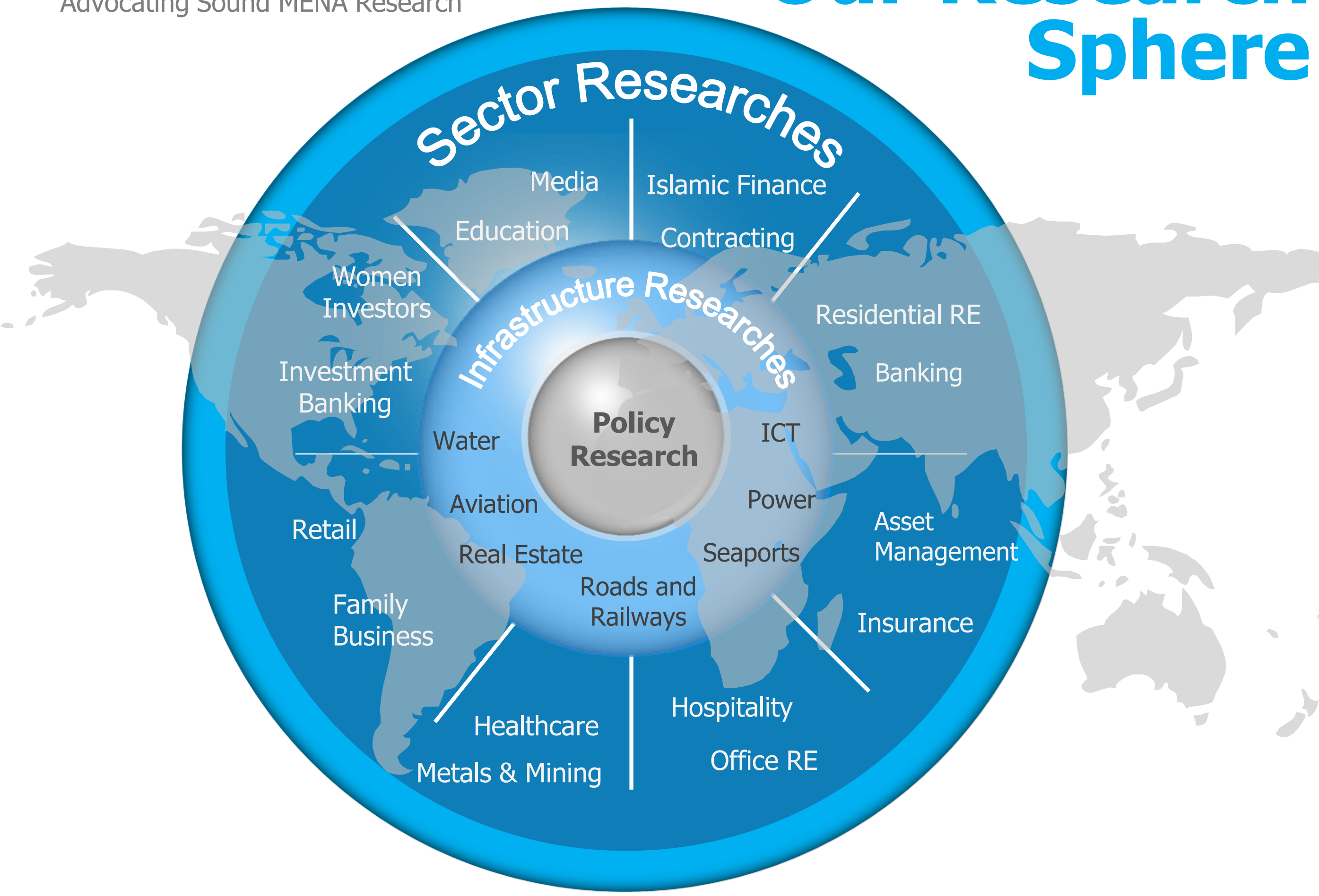

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