
MARKETING STRATEGY RECOMMENDATIONS FOR URUGUAYAN FREE ZONES

Final Report

*Bureau for Private Enterprise
U.S. Agency for International Development*

*Prepared for: USAID/Uruguay
and the
Direccion de Zonas Francas*

Prepared by: The Services Group

*Sponsored by: Private Enterprise Development Support Project II,
Project Number 940-2028.03
Prime Contractor: Arthur Young*

July 1989



Arthur Young

A MEMBER OF ARTHUR YOUNG INTERNATIONAL

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1815 N. Lynn Street, Suite 200
Arlington, VA 22209
(703) 528-7444*

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EXECUTIVE SUMMARY

I. Purpose

This report presents recommendations on positioning the Uruguayan free zone program to compete effectively in world markets, following recent major reforms in the country's free zone legislation and implementing regulations. It is intended to assist the Direccion de Zonas Francas of the Ministry of Economy and Finance and other institutions committed to export sector development in Uruguay.

II. Regional Setting

Competitive forces are moving multinational corporations to locate production and distribution systems in countries offering the most favorable factor endowments, business climates, and access to markets. Free zones have proven especially attractive to such firms -- most notably to small and medium sized export enterprises that lack the inclination and negotiating stamina to establish operations in complex and highly regulated environment.

In recent decades, assembly and light manufacturing operations have eclipsed commercial/warehousing activities as the main occupants of free zones, producing labor-intensive apparel, electronics, pharmaceutical, and agro-industrial items for the world market. In the Dominican Republic, as an example, employment in industrial park-style "export processing zones" has risen from 20,000 in 1983 to approximately 90,000 today; Mexico's duty-free maquila industries have grown from 100,000 to 400,000 since 1980.

New service sector industries also are beginning to appear in export processing zones. More than 15,000 data entry and document processing workers now are employed in companies operating under duty-free status in Jamaica, Mexico, the Dominican Republic, and Barbados. High value-added information services, including computer graphics and software development, are also being attracted to free zones in the region. Leading informatics companies have estimated that more than 100,000 jobs will be created in Latin America to serve the North American market.

Competition among Latin American and Caribbean countries to attract such firms in recent years has generated a notable improvement in both the quality and quantity of the region's free zones. Countries such as the Dominican Republic, Mexico, Costa Rica and Jamaica have established free zones with specialized subcontracting and shelter plan capabilities, offering foreign firms alternative forms of business relationships to direct investment in a zone. Specialized training programs, imparting practical skills in demand by zone occupants, have also been created in these countries. Physically, many of the newest free zones in the hemisphere have gone "upmarket," offering high-quality industrial and office buildings and attractively landscaped grounds. Ownership and management of these parks is

almost invariably undertaken by private zone developers, primarily indigenous developers but in some instances actively assisted by foreign investors.

A recent noteworthy change in the pattern of free zone development in the region has been the advent of zone-based satellite earth stations or "teleports," offering dedicated low-cost international telecommunications services. Free zones with operational teleports now exist in the Dominican Republic and in Jamaica. Similar facilities to promote informatics exports are now in advanced planning stages for free zones in Costa Rica and Trinidad.

III. Comparative Advantages of Uruguay: Implications for Free Zones

Uruguay has historically maintained a market-oriented economy, although with varying degrees of Government intervention. During the 1970s, and especially since the advent of democratic government in 1985, more emphasis has been given to systematic use of free market policies and to regional economic integration. Despite some difficulties, exports have responded well to the policies, led by wool, meat, rice, barley, and leather goods.

Uruguay's factor endowments and market access position it well to compete successfully in selected non-traditional export markets. Primary attributes include:

Productive and affordable labor force. Uruguay's labor force, despite having experienced a large decline in compensation relative to North American levels in recent decades, remains highly educated and productive. Comparable productivity in key industrial sectors is obtainable at hourly wages of 30 to 40 percent of current U.S. levels.

Abundant agricultural and natural resources. By virtue of Uruguay's location at the outlet of a major South American river system, economical transportation is possible for a wide range of agricultural and mineral resources from locations deep within the continent.

Proximity to regional markets. Uruguay shares borders with two of the largest Latin American economies, Argentina and Brazil. Its proximity is paralleled by a network of favorable trade agreements, providing across-the-board tariff exemptions for many Uruguayan products sold to its neighbors.

Offsetting these assets to significant degrees, however, are problems in the following areas:

High transportation costs to European and North American markets. At present, ocean freight charges to Uruguayan exporters shipping to New York are approximately \$3100, far higher than for many competitive free zone-sponsoring countries. Air freight rates are similarly above average to North American and European markets.

Noncompetitive international telecommunications services. Dedicated analog voice/data lines today are available through ANTEL at prices that discourage many types of telecommunications-intensive service activities. Competitive free zones make it possible to reduce international telecommunications costs by a factor of three to ten, depending upon the number of dedicated lines leased.

To better assess the differential effects of Uruguayan conditions upon traditional and emerging business sectors, the project team analyzed location factors for a range of potential free zone users. The following sectors appear to have significant potential:

Commercial Operations (Warehousing/Transshipment). Uruguay is well-positioned for commercial firms serving the regional market. Affordable shipping costs to Argentina and Brazil, favorable trade agreements, a stable business climate, and a respected banking system make the country uniquely attractive. Difficulties in accessing affordable international telecommunications and air passenger/freight services, particularly near Colonia, constitute the major current obstacles to growth in this sector.

Apparel. Uruguay stands to attract up-market apparel assembly and textile operations, given the availability of high quality labor, natural fibers, and the existence of unused quota allotments for export to the U.S. market. The optimal market segments for the country are products with high labor content to weight ratios, infrequent in-season reorders, decentralized cutting and parts preparation, low brand-name identification, and smaller production runs. High ocean and air freight costs at present work against the rapid development of this sector, as does competition from lower labor cost countries in Latin America.

Food processing and related industries. Access to a range of agricultural and maritime harvests positions Uruguay to be a strong competitor in selected food processing operations. In recent years, the dominance of large multinational corporations in food processing operations has diminished, creating opportunities for bulk and intermediate processing by local and regional firms. Typically, such operations require ports with reliable and affordable services and dependable sources of supply.

Electronics assembly. Uruguay also appears capable of attracting some segments of the electronics industry. The products most suited appear to be electronic components, subassemblies and consumer electronics products. Within these segments, Uruguay appears to have greatest potential to attract producers whose products have high value to weight and price to volume ratios, and whose markets are regional rather than international.

Assuming that demonopolized international telecommunications services are installed, many information processing services also have a close fit with Uruguayan factor endowments.

Data Entry/Office Support Services. Two types of data entry operations exist: slow-turnaround (48 hours or more) and fast-turnaround (less than 48 hours). Uruguay appears to be uncompetitive for slow-turnaround data entry operations because of high air freight and labor costs relative to competitors. For telecommunications-intensive fast turnaround operations, however, the introduction of teleports in Uruguay could make the country highly competitive, especially for operations requiring high skill and interpretative abilities.

Computer-Aided Drafting and Design (Digitizing/Vectorizing). The proliferation of Computer-Aided Design (CAD) systems among U.S. firms has created a huge demand for converting paper documents into computer-readable files -- a labor-intensive "digitizing/vectorizing" process. Uruguay could be highly competitive with other nations in the hemisphere for attracting such operations, given its caliber of workforce. Labor cost savings for Uruguayan CAD operators, relative to U.S. salaries, are in excess of US\$20,000 per year.

Software Services. An enormous demand exists in developed countries for software development, programming, customization, and maintenance. Improvements in telecommunications have made possible low-cost, frequent long-distance interaction between offshore programmers and their clients -- a crucial advantage for Latin America relative to export-oriented software service bureaus now employing thousands in India, China, and the Philippines. Successful development of this sector on a large scale, however, depends upon shifting training toward new programming languages. Uruguayans earn approximately US\$20,000 less per year than U.S. programmers of comparable skill and experience.

Voice Center Operations. The labor-intensive nature of many telephone operator services--such as 800-number operator centers, answering services, and telemarketing operations--creates opportunities for offshore locations with favorable labor costs. Spanish-language capabilities are needed to serve the growing Hispanic population in the U.S. Such voice center operations require low monthly telecommunications prices; costs in excess of US\$1000 per line rapidly offset any labor savings from an offshore location. Average salary differences between bilingual operators in the U.S. and bilingual counterparts in Uruguay are more than US\$10,000 annually.

Sectors suited for development in Uruguay varied by geographic area examined. The Rio Plata estuary brings special advantages to commercial operations serving regional markets. Colonia is a prime base for warehousing and processing of goods with origins or

destinations in Buenos Aires. At Nueva Palmira and Fray Bentos, clear opportunities exist for both bulk shipment and processing of soybeans and produce, and potentially of manganese. Horticulture and fruit processing operations seem feasible for Bella Union and for Rio Branco. Fish processing (and possibly repair refuelling for foreign fishing fleets) has apparent potential in the La Paloma/Rocha area. By contrast, high labor costs in Punta del Este appear to make this location unattractive for most traditional free zone industries.

More skill intensive assembly and manufacturing operations are best suited for the Montevideo metropolitan area. Given the high costs of freight rates to international markets, such industrial product should be oriented principally to Argentine and Brazilian markets, and/or make extensive use of export-grade Uruguayan textiles and leather. In the case of informatics exports, Montevideo also holds a clearly prime position. Given that satellite telecommunications are virtually distance-insensitive by nature, Uruguay's human resource endowments could be readily accessible to North American firms with information processing requirements. La Paloma and Colonia also may have a sufficient supply of skilled workers to sustain a limited range of export operations in these sectors.

IV. Competitive Assessment of Uruguayan Incentives/Institutional Framework

Established in 1923, the Uruguayan free zone program languished in its initial decades. Zones at Colonia and Nueva Palmira succeeded in attracting some warehousing and transshipment firms oriented principally to the Argentine market. Constraints with physical infrastructure and facilities, minimal incentives, and a lack of promotion contributed to the under-utilization of the zones.

Uruguayan industries throughout most of the post-war period made greater use of alternative incentives regimes such as the Temporary Admission Program and the Industrial Promotion Program. However, amendments to the free zone regime, enacted in late 1987 and supported by implementing regulations in mid-1988, made the free zone regime unquestionably the the most attractive of all Uruguayan incentives available to the export sector. The revisions in the free zone law gave lessees in free zones a guarantee that the buildings that they paid for and constructed in public zones would not be considered government property, thereby releasing private resources for badly needed new facilities construction. The law guaranteed freedom for zone-based firms to conduct business in dollars, and created the future option of private management and ownership of free zones. Concurrently, the law allows for relief from the "implicit taxes" of Government monopolies by authorizing -- for the first time in any free zone statute worldwide -- the demonopolization of public sector utilities.

A comparative analysis undertaken by the project shows that Uruguay, overall, has the strongest free zone legislative package in the region. Along the criteria of formal tax relief, Customs exemptions, free handling of foreign exchange, and especially the demonopolization of public sector commercial services, the Uruguayan incentive regime has few if any rivals.

Along several other dimensions, however, the free zone program is undistinguished or lagging in comparison with competitors. Currently, an investor experiences a somewhat cumbersome process of application review and approval. The primary constraint in this process appears to be the severely understaffed and underequipped office of the Direccion de Zonas Francas. Substantial problems have been reported by companies operating in the Colonia and Nueva Palmira zones in expeditiously clearing goods through Customs. By late 1988, however, zone tenants reported that the problems of "border" clearances of free zone goods were being ameliorated, as a result of new Customs policies of single-point inspection.

Intense zone user dissatisfaction exists with the present public sector management of the operational zones. Users feel that a hands-on, pro-active management system had yet to be put in place. The most frustrating problems of users were encountered as a result of the underdeveloped free zone infrastructure, including roads, water, and sewerage systems, although belated budget allocations have led to a recent large-scale effort to remedy the majority of these shortcomings. As noted previously, the existing Uruguayan zones at present fare poorly in comparison with zones of other countries in terms of telecommunications price and service connection delays.

Finally, the Uruguayan free zone "package" at present lacks sectorally oriented amenities, such as targeted training programs and specialized subcontracting/shelter program capabilities. Competitive pressures are leading international companies increasingly towards zones that provide such additional inducements for investment.

Notwithstanding these constraints and an almost complete lack of publicity and formal promotion in developed country markets, the free zones now operational in Colonia and Nueva Palmira have a lengthy list of investors requesting space. With removal of the remaining procedural, infrastructural, and related bottlenecks, the rapid growth of Uruguayan free zones appears to be inherently feasible.

V. Indicators of Future Demand for Uruguayan Free Zones

To gain a sense of future market response to the Uruguayan zone program, TSG and its local associates in the project conducted a preliminary survey of prospective zone users and developers. An unusually high level of interest was found. Three North American companies contacted expressed intentions to make first-hand visits to examine free zone related business potentials, and two others

are candidates to provide subcontracting business on a trial basis. The most active interest among North American prospective zone users was found in information services companies such as fast-turnaround data entry and software services. Among potential zone development partners, telecommunications service providers generated the most tangible responses. A Canadian developer of industrial properties in Mexico's maquila program also appears ready to risk an investment in zone buildings, conditional upon enforceable lease contracts with Uruguayan zone tenants.

Among the South American firms contacted, high levels of interest were found in 21 of the 42 firms surveyed. The major activities represented among the highly interested firms were in the commercial, light manufacturing, and industrial machinery sectors. Potential private developers have also been identified in the course of the South American market survey, with interests in developing new free zones. A leading Uruguayan developer of office properties and shopping centers has a site identified for a services and informatics-oriented free zone with a teleport component. (The cost of teleport earth stations is as low as \$75,000, with an installation and testing lead time of as little as four months.) An Uruguayan engineering firm has definite plans to proceed with a private free zone, assuming Government authorization, near the airport in the next six to twelve months. At the existing free zones of Colonia and Nueva Palmira, several private investors already located there could become developers as well.

VI. Strategic Decisions To Promote Effective Marketing Of Uruguayan Zones

The experience of free zone programs in other countries has generated "rules of thumb" regarding successful zone promotion campaigns. The first and foremost area of attention should be to be create a marketable and distinctive product; any shortcomings in zone-related policies and procedures, infrastructure, services, financing mechanisms, and management should be resolved as a matter of highest priority. Second, experience has shown that the most effective zone promotional programs are those undertaken by businesslike staff, who gain credibility with clients through knowledgeable and professional representation. Finally, successful free zone promotion programs rely upon the use of cost-effective media for promotion, including above all endorsements/referrals from satisfied free zone tenants.

As applied to the Uruguayan free zone program, the following strategic decisions accordingly stand to maximize private sector response:

Creating a Marketable and Distinctive Free Zone "Product." Immediate decisions are recommended concerning the improvement of the existing Uruguayan free zone program. Specifically, decisions by Government should be made toward the following end:

Increasing the simplicity of the investment approval process. A

decision should be made regarding the free zone program in Uruguay to create the maximum in simplicity: a Singapore or Hong Kong-style investment registration system, in which a prospective free zone user can complete the paperwork to begin operations in a single morning or afternoon. Alternatively, a true "one stop" investment application approval center should be created.

Privatizing the existing public sector zones. To resolve the present deterrents to business expansion within the zones, the Ministry is strongly urged to make a policy decision in the near term to transfer all further zone development and management responsibilities to private parties, and to announce an international tender for bids by private developers to purchase or lease the zone lands for further development.

Creating guidelines for designation of additional private zones for new technology-intensive sectors. With equal priority, it is recommended that the Government announce its intention to designate new private zones in the Montevideo region, oriented toward technology-intensive sectors. The competitive analysis and the market survey suggest opportunities exist for such projects. The New Technology Zone (or zones) would be open to firms in all sectors, but the training programs and other amenities offered should constitute a world-class package for targeted sectors.

To stimulate such private sector initiatives, the Ministry of Economy and Finance is urged to issue clear designation criteria for private developers regarding the creation of New Technology Zones. These criteria should give primary weight to: (1) the amount of risk capital or other private resources committed to the project and (2) the inclusion of special amenities oriented to technically advanced sectors. Specifically, developers should be asked to include plans for "business incubator" facilities in their proposals, catering to Uruguayan entrepreneurs. To ensure the most rapid possible success of the New Technology Zones, the Government should permit the new private zone developers to offer temporary free zone space in existing industrial and/or office properties, subject to agreement on transferring the incoming tenants to the new site within a specified period.

Helping private sector international telecommunications providers. Recent sharp declines in satellite earth station costs make it unquestionably feasible for private developers to install teleports in free Uruguayan zones. The Government of Uruguay should explicitly affirm its readiness to give priority approval to teleports servicing firms within the zone boundaries. The Government should also initiate any necessary coordination with INTELSAT regarding the use of the Pan American Satellite or other competitive systems.

Encouraging development of zone-affiliated subcontracting capabilities. In addition to encouraging new private free zones to include business incubator facilities, the DZF and/or the Ministry of Economy and Finance should encourage developers to create zone-affiliated subcontracting and shelter programs.

Incentivizing institutions concerned with free zones (and the export sector in general.) As a means of incentivizing the Customs Service to work towards a successful EPZ program, consideration should be given to introducing performance-linked budgeting, providing budgetary supplements to Customs proportional to the total number of firms doing business under the free zone regime.

Upgrading educational and training systems. Establishment of market-sensitive educational and training systems will be especially critical to Uruguayan free zone competitiveness in emerging technology-intensive areas. Work-study opportunities for students in such free zone firms should be developed, along with business inputs into local training curricula. With the advent of free zone teleports, new "distance learning" linkages would become affordable with overseas technical and engineering institutions. These amenities could become integral parts of free zone-affiliated "Centers of Excellence," offering seminars, workshops, and fellowships.

Development of Professional Promotional Institutions. It is essential that the promotion of the free zone program be undertaken as a joint activity between the public and private sector, on a businesslike basis that respects the comparative advantages of each. The following steps can be taken to develop a comprehensive free zone promotional capability toward this end.

Definition of complementary public/private sector roles in marketing/promotion. At the outset, the DZF and/or the Ministry of Economy and Finance should identify a national-level organization with the existing capability (or potential) to present the overall free zone program to the world market. The principal institutional objective of the chosen national investment promotion organization is normally to promote exports and new investment in non-traditional export sectors, including but not limited to free trade zones. Simultaneously, private zone developers should take an active part in preparation of basic promotional materials on the zone, and assistance for investors during their tour of the site. The most powerful contribution to zone marketing success that the developer can make, however, is to ensure that the initial tenants in the zone are satisfied with the conditions they find.

Creation and maintenance of current data bases on investment conditions. All organizations concerned with free zone development can benefit from the establishment of data bases with current information on business conditions. In addition to systematic data gathering from reference materials, field missions should be undertaken by zone promoters to examine successful free zone projects in the hemisphere, including the Dominican Republic, Jamaica, and Costa Rica.

Training of promotion representatives. A number of countries have found it useful to include a national investment promotion program

representative in one of the several free zone training programs that are offered by the Shannon, Ireland Free Zone and the World Trade Institute of New York.

Selection of Cost-Effective Media. The Uruguayan free zone promotion effort should also select its target audiences (by sector and country origin) and chose appropriate media for reaching them with promotional messages.

Developer-targeted programs. Assuming the DZF decides to resolve present constraints by privatizing the present public sector zones and/or authorizing new zones, immediate steps should be taken to promote partnerships with between local and foreign developers. Immediate potential appears to exist for attracting Hong Kong developers to such partnerships, given the recent political turbulence in China. Opportunities should also be promoted to such organizations as the U.S.-based National Association of Office and Industrial Parks.

User-Targeted Programs. In South America, the zone promotion program should focus on firms in such categories as Certificate of Origin-sensitive assembly and manufacturing industries, as well as on Uruguayan firms seeking to enter neighboring markets under bilateral and regional trade agreements. In promotion directed to North American, Asian and European markets, the focus should be on companies seeking to produce or source woollen clothes, leather products, low-weight/high value items (e.g. precision machinery and specialized electronic components and finished products) and telecommunications-sensitive informatics services.

The final key to a successful free zone marketing strategy for Uruguay will be the emergence of a forceful institutional advocate for free zone operators and users. Users and developers of free zones in Uruguay are likely to run into obstacles that may from time to time impinge upon their operations. Accordingly, the DZF and/or the Ministry of Economy and Finance should give highest priority to the mission of troubleshooting for the free zones of Uruguay. To the extent deemed desirable toward this end, the DZF and/or the Ministry of Economy and Finance might take responsibility for organizing associations of free zone users and developers and for serving as their voice in day-to-day matters with the Government.

Conclusion. By virtue of its unusually far-reaching legislative reforms, Uruguay today has perhaps the most substantively attractive free zone statutes and implementing regulations in the world. A strong commitment to remove the remaining obstacles -- notably by Government authorization of private zone developers and infrastructure providers to proceed rapidly with proposed projects -- will enable Uruguay also to be a world-class free zone competitor in the quality of the physical package and amenities offered to zone users.

I. INTRODUCTION

A. PURPOSE

1.01 This report presents recommendations on positioning the Uruguayan free zone program to compete effectively in world markets, following important reforms in the country's free zone legislation and implementing regulations that included, among other provisions, comprehensive demonopolization of public utilities within the zones. The project is intended to assist the Direccion de la Zona Franca of the Ministry of Economy and Finance and other institutions committed to export sector development in Uruguay.

B. METHODOLOGY

1.02 The project was undertaken at an opportunity identification level of analysis, supplemented by an initial market test to determine the potential private sector demand for participation in Uruguayan free zones. As called for by the scope of work, the project team analyzed the competitive context, including economic conditions influencing the development potentials of Uruguayan free zones relative to attributes found in competitive free zone programs. High potential industry and service sectors for Uruguay were thereby identified, and preliminary conclusions were reached regarding the potentials (or lack thereof) of alternative possible free zone locations within the country. The project team then assessed the degree to which the existing legislative and institutional framework governing free zones in Uruguay would permit high-potential free zone locations to realize their inherent economic potential. Following this assessment, a limited sampling of potential zone users, infrastructure providers, and developers was undertaken in both South and North America. The responses to this sampling, combined with the critical review of the legislative/institutional framework described earlier, formed the basis for strategic recommendations. In the final report, the project team will utilize client comments on the proposed strategy in helping to prepare specific action recommendations.

C. ACKNOWLEDGEMENTS

1.03 The research and analysis were undertaken through a U.S. Agency for International Development-funded project conducted by The Services Group (TSG) under subcontract to Arthur Young, through the Bureau for Private Enterprise's Private Enterprise Development Support (PEDS) program.

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II. REGIONAL SETTING

A. DEMAND TRENDS

2.01 Competitive forces are driving multinational corporations to locate production and distribution systems in countries offering the most favorable factor endowments, business climates, and access to markets.

2.02 In Latin America, a growing influx of direct investment is underway to the region's free zones, despite concerns on the part of foreign investors about the general business climate in the region. Free zones, normally encompassing from 10 to 200 hectares, offer an environment of concentrated economic policy liberalization. From an investment promotion perspective, free zones directly address the apprehensions often felt by firms about doing business in an unfamiliar environment, by signalling that clear, market-oriented policies will apply to zone occupants in a routine and straight-forward manner.

2.03 Free zone incentives--consisting of tax, Customs duty, and regulatory abatements--were in past centuries most utilized by firms engaged in the storage and transshipment of goods. A new variety of free zone, called the export processing zone (EPZ), began proliferating in the mid-1960s. These industrial estate-style zones, which make incentives available to export-oriented assembly and light manufacturing operations, have accounted for much of the ensuing export success of Taiwan, Korea, Singapore, and Malaysia. In the past decade, several Latin American countries have achieved notable results with export processing zone policies as well. In the Dominican Republic, as an example, free zone employment has risen from 20,000 in 1983 to approximately 90,000 today; the workforce in Mexico's duty-free maquila zones has grown from 100,000 to 400,000 since 1980.

1. Established Sectors

2.04 The primary industrial users of export processing zones world-wide, including the Latin American zones, are labor-intensive assembly and light manufacturing operations. The following sectors are representative of zone users now operating in Latin American and Caribbean free zones:

2.05 *Apparel assembly.* The leading industry sector for free zones in the western hemisphere consists of apparel assembly operations. In some countries, such as the Dominican Republic, the sector accounts for more than three fourths of the cumulative total of approximately 70,000 new jobs established in its free zones since 1983. Apparel operations that have successfully taken hold in Latin American and Caribbean free zones include men's and women's dress shirts, sport shirts, sportswear, pants, and undergarments. Much of the investment has been made by Asian producers facing

Multi-Fiber Arrangement (MFA) quota limits and rising labor costs in their original production sites; the western hemisphere has presented fewer such problems to date. Moreover, the proximity to U.S.-origin textiles makes possible preferential access to the North American market, under Section 807 of the U.S. Tariff Schedule. This program enables companies to source components and fabric that have been cut in the United States, and to pay duties upon their re-export back to the U.S. only on the value-added in the offshore location, provided that at least 35 percent value is added to the product in the process. (In most free zone sponsoring countries in the region, the 807 program accounts for more than 90 percent of all apparel exports.) The optimal market segments for free zones in Latin America are products with high labor content-to-weight ratios, infrequent in-season reorders, decentralized cutting and parts preparation; low brand-name identification, and smaller production runs. Preferred sites for plant location are close to urban centers with an abundant female workforce and mid-level managers. (More detailed information on the apparel sector, and others that follow below, is provided in Appendix A of this report.)

2.06 *Electronics assembly.* The Dominican Republic, Mexico and El Salvador have also attracted a number of segments of the electronics industry for export-oriented operations. The products most suited for free zone production, in general, are electronic components and subassemblies and consumer electronics products. Within these segments, Latin American zones have generally attracted products that have high value-to-weight and price-to-volume ratios, and are destined principally for the U.S. market. Because of their generally high value and low weight, electronics products are often shipped by air. Relatively short and specialized production runs and rapid turn-around times are a primary attribute of many electronics assembly operations based in Latin American and Caribbean free zones, giving them an edge over the competition of lower labor-cost countries elsewhere in the developing world.

2.07 *Food processing/agro-industrial operations.* In this sector, free zone-based export operations presently include fish processing, bio-engineering of palm oil seed, cigar manufacturing, and candy manufacturing. Typically, such operations require ports with reliable and affordable services and dependable sources of supply. In recent years, the dominance of large multinational corporations in food processing operations has diminished, creating opportunities for bulk and intermediate processing by local and regional firms. Among the fastest growing exports of processed foods from developing countries are specialty foods and exotic spices, sauces, and jellies. Although the European Community is the largest consuming market, the United States remains more open to imports. On occasion, companies in this sector operating under free zone incentives are physically separated from other zone firms, to locate close to their primary inputs or to minimize the effect of odors or effluents generated by the production process.

2.08 *Other assembly/manufacturing.* Several major multinational pharmaceutical companies have also been attracted to free zones in the region. In the Dominican Republic, companies such as Baxter Travenol and Eli Lilly have established export-oriented production centers, as have four pharmaceutical companies in Freeport, Bahamas. Furniture is exported from other Latin American free zones, as are shoes and other leather products. Toys and sporting goods are also being produced in increasing number by Latin American and Caribbean free zones.

2.09 The overall growth of user demand for free zones in the region has been impressive. In four countries for which detailed absorption rate data are available (Costa Rica, Dominican Republic, El Salvador, and Jamaica), a recent TSG analysis found the combined annual increase of leased space to be more than 480,000 sq. ft. In the Dominican Republic alone, the amount of zone space being leased has increased at an average annual compound rate of 64 percent since 1970. The above figures do not include industrial property leasing data for the maquila program in Mexico, which has seen employment grow at an average compound rate of more than 30 percent since 1980 (from 100,000 to 400,000). Assuming conservatively an average of 100 sq.ft. per worker, the total area of industrial property now leased or sold to Mexican maquila industries now exceeds 40 million square feet.

2.10 Although North American firms still account for the majority of investment in Latin American export processing zones, the share of free zone activity generated by indigenously owned enterprises and by Far Eastern firms has been growing rapidly. Indigeneous entrepreneurs have found profitable niches by establishing subcontracting firms, given the reluctance of many North American and European firms to commit direct investments in recent years to the region. Asian entrepreneurs, by contrast, more typically operate on a direct investment basis. Recent political instability in China has increased the apprehension of the Hong Kong business community about the approaching 1997 absorption into China. The fulfillment of quota limits under the MFA for Far Eastern countries can be expected to accelerate movement of apparel operations to Latin free zones.

2. New Sectors

2.11 New service sector industries also are beginning to appear in export processing zones. Over the past 15 years, the economies of industrialized nations have been shifting decisively towards information services. Many of the services demanded by North American consumers in information technology-oriented economies are labor intensive. Insurance claims, responses to direct mail solicitations, processing of coupons and warranties, and inventory management systems all place heavy demands upon keyboarding operations. Telephone centers handle millions of calls per week in reservation and telemarketing centers. Software development and

programming demands have stimulated rapid growth in service bureaus. Recently, with the creation of Computer-Aided Design (CAD) and electronic publishing work stations, tens of thousands of architects, engineers, writers, and editors have radically changed their work habits. Latin American and Caribbean Basin countries have been leaders in attracting these new sectors.

2.12 *Low value-added information services.* More than 15,000 data entry and document processing workers now are employed in companies operating under duty-free status in Jamaica, Mexico, the Dominican Republic, and Barbados. Keyboard operators utilizing personal computers have relied primarily on air freight to receive source documents and send back tapes and disks. Increasingly, however, satellite communications is being used both to send the source materials (via high-speed facsimile) and to return the processed file (via modem).

2.13 *High value-added information services.* A range of new "upmarket" information industry operations, including CAD and software development services, are also being attracted to the Latin America/Caribbean region under a variety of duty-free incentive regimes. Four locally-owned CAD service bureaus, transforming U.S. maps and engineering documents into digitized files, have recently been established in Jamaica. In the Dominican Republic, more than 300 CAD draftsmen, architects, and civil engineers have been hired by a subsidiary of GTE to convert paper maps and telephone cabling plans into computer-readable form. Toll-free operator services are now also being provided by GTE for calls originating in the United States.

2.14 As computer and communications costs continue to fall, leading informatics companies have estimated that more than 100,000 jobs will be created in Latin America to serve the North American market. The proliferation of affordable modems and facsimile equipment (now found in more than 700,000 U.S. offices) makes it technically feasible for even small North American firms to establish productive subcontracting relationships with offshore informatics firms.

B. SUPPLY TRENDS

2.15 Competition among Latin American and Caribbean countries to attract offshore investment in recent years has generated a notable improvement in both the quality and quantity of the region's free zones. As of early 1989, 21 countries in Latin America and the Caribbean have implemented free zone programs with primary emphasis on industrial exports. The number of operational industrial park-style export processing zones in the region now stands at more than 55.

1. Profiles of Zone Development Programs

2.16 The following are examples of leading free zone initiatives in Latin America and the Caribbean Basin of special relevance to Uruguay:

2.17 *Argentina.* To date, the majority of Argentina's free zone activity has been commercial rather than industrial in nature. The country has established more than a dozen transit zones for inward and outward movement of goods to neighboring countries, including Brazil, Chile, and Paraguay. The largest transshipment zone is a 370-hectare free port adjacent to the Port of Rosario, designated in 1969 to support Bolivian trade. Other duty-free facilities have been established for national development purposes, including a Customs-free perimeter encompassing Tierra del Fuego (designated in 1956 and reinforced with tax benefits in 1972). To date, the activities benefiting from the Tierra del Fuego Customs zone have principally been sheep ranching, forestry, and oil exploration. The administration of President Menem is reported to be favorably disposed towards export processing zone creation, as a means of stimulating jobs and export earnings.

2.18 *Brazil.* Since 1967, Brazil has operated an "export processing zone" in the Amazonian city of Manaus, with mixed results. Approximately 30,000 jobs have been created in the assembly and manufacturing operations located within the 10,000 sq. km. zone area, although a substantial portion of the goods appear to have been illicitly diverted into the Brazilian market. The principal industries locating within the EPZ include consumer products (motorcycles, apparel, stereos, radios, calculators, television sets, adding machines, cash registers, eyeglasses), diesel engines, and a variety of products combining local with foreign inputs, including plywood, detergents, tin smelting, and food processing. In 1987, President Sarney of Brazil announced that six additional EPZs would be designated in the country, as part of a new emphasis on export-led development. The new zone initiative has been controversial in Brazil, in part because of apprehensions by local industrialists over competition from potential further EPZ contraband, and in part because of allegations that Sarney's close political allies are to be the primary beneficiaries of the program.

2.19 *Colombia.* In 1958, Colombia has authorized free zones for commercial operations; in 1970, the legislation was expanded to make industrial operations also eligible for incentives. The principal Colombian zones at present are located at Barranquilla, Cartagena, Buenaventura, Palmaseca, Cucuta, Rionegro and Santa Marta. All are under the ownership and control of autonomous public sector organizations. Apparel operations account for the largest share of free zone activity, followed by metal products fabrication and production of household appliances. As of the beginning of 1989, Colombian free zones directly employed more than 6300 workers in 70 zone-based firms. The World Bank-financed

free zone at Cartagena is considered an "upscale" industrial park facility, with extensive landscaping and amenities; other Colombian zones are oriented to low- and middle-market tenants.

2.20 *Chile*. Activated in 1976, the Chilean free zone at Iquique at present employs more than 3600 workers, approximately one third of which are engaged in industrial operations in a total of 38 manufacturing/assembly firms. The products--destined for regional and North American markets--include plastic goods, cosmetics, metal fabrication, paper and cartons, and printing. The Iquique zone is owned and operated by the public sector, and occupies approximately 240 hectares.

2.21 *Costa Rica*. For seven years after the commencement of its free zone program in 1978, Costa Rica experienced slow growth in its free zones. The major hindrances were poor zone locations (limited initially to sites far from competitive labor markets and air transportation links), and problems resulting from a public sector monopoly over the development and ownership of free zones. With the legislative reforms of 1985, a number of sophisticated private firms have embarked upon zone development initiatives, culminating in operational zones at Cartago and Alajuela, and several others under construction. The Cartago free zone has been a leader in the hemisphere in providing zone-based training facilities for workers, in cooperation with the National Training Institute. It has also organized subcontracting services for foreign companies wishing to do business with (rather than directly invest) in a zone-based operation. Given the contrast between the performance of the private and the government-owned zones, the Government of Costa Rica has decided to privatize its existing public sector zones at Limon and Puntarenas, and is now reviewing tenders. Other innovative steps taken by the Costa Rican free zone program include the first debt-equity conversion for financing free zone development, and plans for the first free zone-sited Science-Based Park in the region, catering to up-market technology-intensive users, with a focus on bioengineering and information industries. Discussions regarding the installation of private telecommunications facilities are now underway with major multinational service providers.

2.22 *Dominican Republic*. The Dominican Republic has the Western hemisphere's most active export processing zone program, with thirteen operational zones, six under construction, and more than a dozen additional zone projects in a formative stage. At present, more than 90,000 workers are estimated to be employed in the zones, primarily in the apparel assembly sector. A number of Fortune 500 firms have established operations in the country's "upscale" free zones, which provide industrial and office park facilities and amenities at par with North American and European properties. The rents charged by such zones (which are privately owned and operated) average three times more than public sector free zones oriented toward the low end of the market. The San Cristobal (Itabo) and San Isidro zones have developed labor recruitment and training services, as a means of strengthening the

appeal of their zones to desirable tenants. The developer of the San Cristobal zone has also created "shelter plan" facilities to allow foreign firms the option of renting a fully staffed production plant rather than making a direct foreign investment. Recently, high-quality, low-cost international satellite telecommunications links were established in the Dominican Republic to provide free zone users with a direct link to overseas parties. To stimulate growth of informatics operations, GTE opened in late 1987 a teleport (a satellite earth station offering direct connections rather than switching users through the public telephone system) with fiber optic links to the informatics-oriented Dominican zones. In May 1989, a competitive element was introduced, with the opening of a new teleport providing dedicated voice/data lines to the U.S. at costs as low as one fourth of the present dedicated line rates between the U.S. and other countries in the region. Through an arrangement with PanAmSat, a new Intelsat-authorized "separate satellite" system, low-cost, dedicated 64 kbs lines have been made available between the San Isidro Free Zone and North America. American Airline's free zone-based data entry subsidiary at present has 600 employees, and plans to hire an additional 600 within the next year.

2.23 *El Salvador*. The San Bartolo Free Zone, just outside San Salvador, is one of the most profitable offshore production locations for AVX Ceramics, a leading multinational electronics manufacturer. The public sector zone, employing more than 3,800 people, benefits from the ample supply of highly productive, low-wage labor. In its revised Foreign Investment Law of 1986, the Government made possible private development of free zone projects for the first time. Several interested local developers are now in the planning stages of new zone projects.

2.24 *Jamaica*. After a slow start from 1978 through 1983, the Kingston Free Zone proved successful in attracting a number of large Far East apparel firms, fully leasing a 17 hectare World Bank-financed site by 1987. Subsequent labor-management problems and a devastating hurricane in 1988, however, have seen zone employment drop from approximately 12,000 to 6,000 workers. The Jamaican government in 1985 embarked upon development of a second public sector-managed free zone in Montego Bay, although difficulties in construction forced incoming companies to wait two years or longer for space to be made ready. The Montego Bay project, however, proved distinctive by establishing an office park element catering to labor-intensive information industry operations. In late 1988, a joint venture teleport (with majority ownership by Cable & Wireless and AT&T) was opened, offering substantial quality improvements and price reductions to export-oriented information processing firms. This facility can serve offshore reservation centers and telemarketing operations, as well as provide data entry firms with high-speed facsimile transmission capabilities to make possible fast-turnaround services. Reported pricing policy disagreements among the teleport partners, however, have to date kept prices for dedicated lines significantly higher than those charged for comparable services in Dominican Republic free zones.

2.25 *Mexico*. Mexico has also experienced rapid growth in export-oriented, duty-free assembly operations. More than two dozen major private and publicly operated industrial parks now serve firms in Mexico's "maquiladora" sector, which has grown in employment from 100,000 to 400,000 since 1980. The major industrial operations in the maquilas are electronics assembly (27 percent of value added), automotive/transportation equipment (23 percent), electrical machinery and supplies (18 percent), furniture/wood products (6 percent) and textiles (less than 5 percent). The Bermudez Industrial Park in Juarez stands as an example of a privately owned estate offering services, amenities, and campus-style design comparable to leading North American industrial parks. As a means of stimulating growth of export-oriented information processing activities, including data entry, software development, and CAD digitizing/vectorizing, the Mexican Government has recently allowed at least one leading U.S. multinational corporation to establish a dedicated international voice/data satellite earth station within an industrial park, on the provision that ownership be transferred immediately to the Government.

2.26 *Panama*. The Colon Free Zone in Panama, established in 1948, is the leading commercial zone in the western hemisphere. It has served as a regional transshipment and wholesaling center for consumer goods imported from countries around the world. As of the mid-1980s, the free zone employed a reported 12,000 workers. The advent of Panama's political troubles, combined with the depressed purchasing power of many Latin American consumers, has adversely affected the level of activity of the zone in recent years.

2. Emerging Trends in Zone Supply

2.27 The following trends are evident from a review of the free zone initiatives being undertaken by Latin American and Caribbean countries:

2.28 *Private ownership and management of zones is becoming standard*. The consistently more user-responsive and market-driven performance of private zones has persuaded governments throughout the region to rely upon private rather than public zones. In the case of the "high end" office and industrial parks, the lead is almost invariably taken by private zone developers, primarily indigenous developers but in some instances actively assisted by foreign investors. Private parks in the Dominican Republic, Costa Rica, and Mexico are at par with advanced industrial and office parks in the developed countries.

2.29 *Specialized rather than general purpose physical facilities are gaining market share*. When zones were less numerous throughout the hemisphere, few zone developers took steps to distinguish their "product." Today, a growing number of free zones in developing countries are orienting their properties towards specific market segments. The trend is particularly evident in the

establishment of office park-style facilities for labor-intensive information processing services. Data entry operations are a primary target for zones in Jamaica, Dominican Republic, and Barbados. In some cases, zones in the Caribbean have also begun to attract software development/maintenance operations, CAD, and publishing services. In many respects, this trend parallels the emergence of office parks in North America and Europe over the past 15 years in step with the growth of the service sector in the developed countries. The physical appearance of the new zones places a premium on appropriate landscaping as well as on buildings. Landscaping is used intensively to blend buildings into the surrounding greenery to achieve a more campus-style setting. Many zone designs now closely follow the natural contours of the terrain, avoiding the "cut and fill" approach that has been traditionally practiced. The industrial and office park areas within these projects provide extensive foliage, open spaces, courtyards, recreational areas, and even bodies of water to enhance their aesthetic appeal. The upscale zones also protect their appearance through protective covenants that specify standards for building materials, maintenance, effluents, and building/land densities.

2.30 *Specialized support services are being offered.* Beyond providing a physical environment optimized for targeted business sectors, free zone developers are increasingly making provisions for other types of amenities. Specialized subcontracting and shelter plan capabilities enable foreign firms to enter into "quick start" business relationships, in the event that they prefer not to make a direct investment in a zone. Countries such as the Dominican Republic, Mexico, Costa Rica and Jamaica have established free zones with these arrangements. Specialized training programs, imparting practical skills in demand by zone occupants, have also been created in these countries, as have pre-screening services to identify high-quality job applicants. In return for bringing such amenities and services to one location, developers of the new "high end" free zones are able to charge premium rents--often three or four times higher than competing public sector projects.

2.31 *New "teleport" communications links are being provided.* A recent noteworthy change in the pattern of free zone development in the region has been the advent of zone-based teleports, offering dedicated low-cost international telecommunications services. Led by free zones in the Dominican Republic and Jamaica, as well as by the Mexican maquila program, the new privately financed teleports enable both industrial and service sector firms to stay in the closest possible contact with their markets. As product lifecycles shorten and demands grow for flexibility in the design and delivery of both goods and services, growing numbers of free zones in the region see teleports as an essential ingredient in staying competitive.

III. COMPARATIVE ADVANTAGES OF URUGUAY: IMPLICATIONS FOR FREE ZONES

A. OVERVIEW OF THE ECONOMY

1. Structure

3.01 Uruguay has historically maintained a market-oriented economy, although with varying degrees of Government intervention. Traditionally based on an internationally competitive agricultural sector, the economy went through a period of diversification after World War II that closely followed the import-substitution model widely applied at the time in most of the Latin American countries.

3.02 The Government has played a central role in the national economy since the social and economic reforms of the 1920s gave rise to a classical welfare state. The degree of state intervention required during the import substitution program -- including export and import duties, tariff barriers, and currency controls -- further expanded the scope of activities of the government and reduced the incentives for independent private entrepreneurship.

3.03 A reorientation towards more systematically free market policies has taken hold over the past 15 years. The shifts in economic policy undertaken to promote private sector, export-oriented activities in Uruguay date back to 1974-1979, with the gradual reduction of such barriers as extremely high import and export taxes and tariffs, along with a more realistic foreign exchange policy. Under the present Administration, these shifts in policies have been confirmed and expanded. Faced with a public sector that employs more than a fourth of the workforce and runs recurring deficits, the Sanguinetti Government has emphasized private entrepreneurship as the main force in economic development, and international competitiveness as the first and foremost criterion for the survival of the Uruguayan economy.

3.04 Key elements of economic policy have been liberalized since 1974, in keeping with the desire of successive Governments to continue on a market-oriented development path. These include:

- full freedom for capital inflow and outflow
- free determination of interest rates
- no taxes on personal income or inheritances
- full exemption of the financial assets of non-residents from net-worth tax
- respect for privacy in banking and financial matters
- exemption of offshore operations, including banking, from Government regulation.

3.05 The Uruguayan private sector has come to recognize that success in external markets is essential to growth. Similarly,

efforts have been made to encourage foreign direct investment, especially in export-oriented sectors. (The specific promotional instruments are analyzed in detail in chapter IV.) Their presence reflects the emphasis placed by recent Governments to giving the private sector the lead role in economic development.

3.06 A further structural trend evident in the Uruguayan economy is its progressive integration with the economies of neighboring countries. Under the present Administration, a network of special trade agreements, especially with Argentina and Brazil, has achieved concrete results such as across-the-board tariff exemptions for many Uruguayan products sold to Argentina (until a 5 percent penetration level is reached), and a Commercial Expansion Protocol with Brazil. This preferential treatment in trade relations with Uruguay by its neighbors reflects a regional awareness of the potential for a common market and, as is discussed further in this report, can be a major element of the promotional strategy of the new Uruguayan free zone regime.

2. Performance

a. Economic Policy Objectives

3.07 With the advent of democratic government in 1985, a series of economic policy objectives were established which, in general terms, have been maintained throughout recent years. The central objectives established were as follows: greater utilization of productive capacity, a reduction in the role of the public sector, improvements in the balance of payments, and the institution of an income policy to support the recovery of real wages.

3.08 Exports were considered to be a key element in the stimulation of the economy and in alleviation of trade imbalances. Therefore, efforts were directed toward maintaining real exchange rates and deepening the commercial agreements with neighboring countries. The lessening of the balance of payments deficit was pursued not only through the increase of exports, but also through rescheduling of foreign debt with private banks, in accordance with the agreement signed with the International Monetary Fund.

3.09 The gradual abatement of inflation was approached by establishing stable monetary policies. In accordance with this goal, the fiscal policy had as its objective the reduction of the public sector deficit as the cutting edge of the anti-inflationary program.

b. Economic Developments in 1987 and 1988

3.10 The results of the economic program delineated above were generally favorable during 1987. However, as summarized below, in 1988 the primary economic indicators registered setbacks in some areas.

3.11 *Economic Growth.* The GDP recorded a growth of 4.9 percent in

1987 over 1986 levels in constant terms. Expressed in current terms with an averaged annual exchange rate, GDP reached US\$7.5 billion. This increase reflected a rise in internal demand through a real increase of 8.5 percent in total consumption and of 25.3 percent in gross domestic investment. The rise in domestic consumption can be attributed to a rise in both the real wages and the level of employment.

3.12 With regard to domestic investment, although the percentage increase is significant, it is important to bear in mind that is a part of a very small base. In spite of this increase it accounted for only 9.4 percent of the GDP, scarcely enough to cover fixed capital depreciation, a clear indication that insufficient investment is one of the principal shortcomings of the Uruguayan economy. For the period 1980-86, Uruguay was second only to Bolivia in the Latin American region for the lowest Gross Domestic Investment.

3.13 In the last trimester of 1987, before expansionist monetary policies had generated a growth in internal demand, measures were taken to "cool" the economy and improve external competitiveness. As a result, internal demand was affected and GDP recorded no change in the first nine months of 1988. While complete data is still not available, a drop in both private consumption and investment in machinery and equipment is evident.

3.14 *Imports and Exports.* The trade surplus, which in 1987 had been reduced to US\$47 million, in 1988 experienced an important recovery, reaching almost US\$260 million. This improvement was largely due to the aforementioned "adjustment" which resulted in a growth in exports while imports remained constant. Imports experienced no significant change, falling only slightly to US\$1.1 billion during 1988. Exports which in 1987 were US\$1.2 billion, reached nearly US\$1.4 billion in 1988, a percentage increase of 17 percent in current terms.

3.15 The categories of goods spurring this export growth included wool, meat, rice, barley, rice, soy, barley, and hides, and to a lesser extent, sorghum, wheat, and various seeds. Citrus production is a sub-sector that has also experienced important growth in recent years, with exports rising from 3,000 metric tons in 1970 to more than 43,000 metric tons by the mid-1980s. When products that have undergone a certain grade of transformation -- dairy products, woolen articles, textiles, cut leather goods, leather apparel, etc. -- are included, these raw materials and their secondary products together account for more than 80 percent of the total exports.

3.16 Another sector of growing importance, also based on primary goods exports with a low level of transformation, is minerals: principally, granite, marble, and materials used for the production of portland cement. These exports have risen from US\$950,000 in 1985 to close to US\$5.5 million in 1986. Finally, the sector referred to as IMSOA (manufacturing industries that

process a raw material not of national agricultural origin) has contributed substantially to the rise in Uruguayan exports, accounting for 18 percent (\$US220 million) of total 1987 exports. This grouping includes two sub-groups: the first, which plays the most important role, entails processing of imported raw materials under the temporary admission system and includes chemical products, steel and iron, plastics, motors, machinery and electrical apparatus, cotton yard goods, synthetic fabrics, etc. The second and smaller category includes processing of national non-agricultural goods, primarily ceramics.

3.17 *Prices and income.* The rate of inflation measured by the changes in the consumer price index (December to December) fell to 57.3 percent in 1987. This decline could not be maintained in 1988, as consumer prices rose 69 percent. The renewal of inflation is a reflection of the acceleration in the rate of devaluation established toward the end of 1987 and the recession experienced in the fiscal variables during the past year. The exchange rate relative to the U.S. dollar had an increase in nominal terms of 54.7 percent in 1987 and of 61.2 percent in 1988.

3.18 Salary levels were influenced by the increase in inflation. In effect, in 1987 the average real wage in the economy had an increase of 6.0 percent, measured from December to December and an annual average of 4.7 percent. These percentages are derived from a growth of the real private salaries of 9.1 percent and 7.9 percent and of the real public wages of 2.3 percent and 0.5 percent depending on whether the last month of the year or the annual average is used as the measurement.

B. FUNDAMENTAL ASSETS AND CONSTRAINTS AFFECTING EXPORT SECTOR DEVELOPMENT

3.19 Uruguay's human resources, factor endowments, and market access appear to make it well-suited for success in a globally-integrated economy. Leaving aside political and procedural issues (examined in the section analyzing export sector incentives and institutions), Uruguay has the following principal factor endowments--and limitations--from the perspective of foreign investors:

1. Basic Production Factors

3.20 *Labor.* Uruguay's labor force, despite having experienced a large decline in compensation relative to North American levels in recent decades, remains among the most highly educated and productive in the hemisphere. Comparable productivity in key industrial sectors is obtainable at hourly wages of 30 to 40 percent of current U.S. levels.

3.21 These attributes are attractive to most free zone industries given the generally labor-intensive nature of their operations. Typically, free zone firms seek to employ between 100-300 workers,

normally women aged between 18 and 25 years on two or more shifts. Because a successful free zone may hold from five to 50 such enterprises, adequate supplies of affordable, trainable, and productive labor are perhaps the most important economic requisite of free zone success. As a rule of thumb, successful free zones are located at sites where population centers of more than 50,000 are within commuting distance. Communities as small as 20,000--or even less--can in certain cases support zone development. Capital intensive industries such as agricultural and mineral processing operations lend themselves especially to location in sparsely-populated areas.

3.22 In Uruguay, remuneration for labor is regulated by the Councils of Salaries organized for each branch of economic activity, in which the businesses, worker representatives, and Government delegates participate. Because it is not possible to determine an "average" wage for labor, the minimum wages are set according to labor categories in these Councils. Both a minimum national salary (monthly) and a minimum daily wage for wage laborers are set. Currently, the national monthly minimum salary is approximately US\$80 and the daily wage minimum is \$3.20. Social charges -- which include pension and unemployment insurance--raise the salary costs by an average of 17 percent, and mandatory health benefits can add as much as 5 percent more, depending on the type of activity. (In certain agricultural sectors such as meat packing and fishing, the pension support is as high as 75 percent; for the informatics sector, the average fringe benefit rate is 35 percent).

3.23 With respect to the variation in salaries among sectors, the following representative examples are presented below (not including fringes):

<u>Occupation</u>	<u>Hourly Wage (US\$)</u>
<i>Wholesale trade</i>	
Salesman:	\$5.06 (includes commissions)
Laborer:	\$1.56
<i>Apparel</i>	
Skilled machine operator:	\$1.13
Foreman:	\$2.24
<i>Metal Products</i>	
Trainer:	\$3.86
Laborer:	\$1.11
<i>Fish Processing Industry</i>	
Machinist:	\$1.62
Factory worker:	\$1.05
Plant supervisor:	\$5.19

Informatics/Service Industries

Typist:	\$1.19
Data Entry Operator	\$1.87
Telephone Operator	\$0.96
Graphic Artist/Illustrator	\$2.10
Draftsman	\$2.67
CAD Operator	\$3.69
Junior Programmer	\$1.59
Senior Programmer	\$2.67

3.24 Some variation in labor costs exists among regions in Uruguay. In areas with substantial tourism, such as Punta del Este, the cost of unskilled and skilled labor is at a premium, with wages over 15 percent higher than in other parts of the country.

3.25 Overall, the availability as well as the quality of workers is excellent. During 1988, national unemployment rose to nearly 9 percent (approximately 50,000 persons), partially due to an increase in the supply of workers. This view differs by sector, however, with unemployment in the manufacturing sector reaching 9.8 percent while in the commerce sector it was 7.9 percent. Moreover, the employment situation varies according to the region of the country, as shown in the discussion of national development poles, which is also reflected in the salary levels in each location. The surplus of highly qualified labor is evident especially at the professional level where an oversupply of technical workers contributes to their migration from Uruguay in a classic example of "brain drain."

3.26 For low-skill, labor-intensive operations, the attractiveness of the Uruguayan labor force from the perspective of many free zone industries is diminished by the availability of lower-cost workers in other countries. In the Dominican Republic, for example, labor costs (including fringe benefits) for factory workers amount to US\$.64/hour. Nevertheless, substantial savings are possible by basing many labor intensive operations in Uruguay, relative to North America.

3.27 *Freight Services.* From the perspective of reaching North American and European markets, Uruguay is at a disadvantage in the cost and frequency of air and ocean freight services. External transport rates can be estimated as follows:

Air Cargo (for more than 1000 kilograms)

Montevideo to Europe:	US\$1,950/metric ton
Montevideo to Asia:	US\$3,300/metric ton
Montevideo to USA:	US\$1,500/metric ton

Sea

Montevideo to New York: \$US3,100 per ten-ton container
or up to 30 cubic meters
Colonia to New York: \$US4,000 per ten-ton container
or up to 30 cubic meters

3.28 These figures compare with costs of less than \$1500 per container for shipping from such countries as the Dominican Republic and Jamaica to the United States. From another perspective--that of shipping to the Argentine and Brazilian markets--Uruguay is extremely competitive relative to other locations.

3.29 The Uruguayan domestic freight transport network includes both rail and truck services. The network of highways and freeways radiate from the central location of Montevideo, and comprise one of the primary deficiencies due to lack of interconnections without passing through Montevideo. On the other hand, the state railroad company (AFE) is reliable and economical. AFE has eliminated many of its less profitable services, including passenger service and service to less heavily trafficked areas. The cargo service to those locations which remain in the railroad schedules has improved. The cargo charges levied for trucking vary according to the volume transported and with the condition of the roads used. Rural roads are especially subject to flooding during the heavy rains of the winter. Trucking charges can be estimated at US\$0.06 per ton/kilometer of the trip. The railroad cargo rates also vary but can be estimated at US\$0.04 per ton/kilometer.

3.30 *Land/Buildings.* A severe near-term handicap to foreign investors considering establishing operations in Uruguay consists of the lack of available free zone buildings and adequately serviced sites for export operations. Free zone sites can take a variety of forms and sizes, from as small as six hectares (Alajuela in Costa Rica) to thousands of square kilometers (1000 sq. km. for Hong Kong, 10,000 sq. km. for Manaus). Typically, free zones catering to export assembly and light manufacturing operations cover a land area of 15 to 100 hectares, with an ultimate building/land ratio of 35 to 50 percent. Successful export processing zones in the intermediate size range normally are designed with phased infrastructure improvements; after clearing and grading the entire site to ensure drainage and a buildable slope of less than 5 degrees, areas of approximately 10 hectares per phase are developed with roads, sewer, water, and electrical service. Typically, standard factory building (SFB) shells of 1000 to 2000 sq. m. under-roof are constructed by the zone development organization to enable interested companies to take occupancy without the normal five- to ten-month construction delay. A number of zones find it easier to lease out building space when the shells are partitionable in increments of approximately 500 sq. m.

3.31 By these standards, Uruguay falls far short of meeting international standards. The existing free zone areas in Uruguay have yet to be adequately prepared with needed infrastructure (although remedial steps by the Government are now in progress). Similarly, no standard factory buildings are available for occupancy on short notice by firms desiring to begin zone operations.

3.32 Few intrinsic barriers exist to remedying these problems. Availability of land is not a constraining factor for commercial or industrial activities in Uruguay. The price of land reflects this situation. The values of land in the Montevideo metropolitan area run between US\$ 1 and 10 per square meter, rising to US\$500/sq.m. for land in the center of the city. Construction costs are highly competitive relative to other free zone-sponsoring countries, where costs may run between US\$250-300/sq.m. for a standard factory building. By contrast, August 1988 statistics for Uruguay show the costs of new industrial property construction (not including a 21 percent tax on added value) at US\$166/sq.m. Higher quality office buildings cost around US\$350/sq.m. for construction. The real estate market, both urban and rural is subject to significant variations due principally to the periodic influence of influxes of Argentine capital which raises the prices of land and buildings in certain areas. The coastal area surrounding Punta del Este is most affected by these external influences, although the rest of the market is also subject to secondary effects of the variations in the price cycle.

3.33 *Capital.* By virtue of Uruguay's open financial markets, private resources relatively available for export-oriented industries. The Uruguayan financial market allows for completely free management of funds and assets. While there is a scarcity of indigenous sources of risk capital for investment, some private as well as public investment financing is available for property development projects.

3.34 *Raw Materials/Intermediate Goods.* Uruguay is favored by abundant agricultural and natural resources. Because of its location at the confluence of major South American river systems, economical transportation is possible for a wide range of agricultural and mineral resources from locations deep within the continent. Domestically, Uruguay also produces substantial amounts of internationally exported wheat, leather, wool, milk, rice, soy, barley, and to a lesser extent, sorghum, wheat, and various seeds. Citrus production for export has increased more than tenfold over the past 20 years. Other primary goods exports with a low level of transformation include granite, marble, amethyst, and minerals used in building materials.

3.35 Intermediate goods are also available at internationally competitive prices, including processed dairy products, woolen articles, textiles, cut leather goods, leather apparel, and ceramics. In addition, Uruguay produces a range of exportable

goods using imported inputs, such as chemical products, steel and iron, plastics, motors, machinery and electrical apparatus, cotton yard goods, and synthetic fabrics.

3.36 *Insurance.* Uruguay has a substantial insurance network for commercial needs including fire insurance, workmen's compensation, automobile insurance, etc. Outside of the free zones, which are exempted from public sector monopolies (as described more fully in the following chapter), these services are offered almost exclusively to the general public by the Government-owned State Insurance bank, although some private firms offer business insurance. Insurance is also available to cover exchange rate fluctuations for export firms. In contrast to the uncertain financial stability of many Argentine and Brazilian insurance companies, Uruguayan private insurance companies enjoy a good reputation in the region.

3.37 *Business Services.* Subcontracting capacity characterizes a growing number of successful free zones. The experience of Caribbean Basin free zones in conducting promotional campaigns indicates that two or three sources of subcontracting work are found for each direct foreign investor prospect identified. Consequently, a zone that offers built-in subcontracting capacities can attract business that would otherwise be lost.

3.38 Relative to other countries in the hemisphere, Uruguay at present suffers from a lack of well-known subcontracting operations in traditional and emerging free zone sectors--notably apparel, electronics, fruit and vegetable processing, and informatics. In other respects, however, essential business services are available. The Chambers of Commerce, the Office of Foreign Trade, the Union of Exporters, and the National Center of Technology and Industrial Productivity (CNTPI) offer technical information oriented to the export sector and advice on how to secure needed support services. CNTPI also offers a consulting service for firms which to gain access to its national data banks. CNTPI, LATU and other associations often also organize seminars, workshops, and courses for management and technicians on operations and administration of export industries.

2. Infrastructure/General Services

3.39 *Telecommunications.* Increasingly, free zone industries require close interaction with home offices, customers, and suppliers to remain internationally competitive. Primary considerations include ease of obtaining local service connections; the ability to use specialized switchboard, facsimile, and computer equipment; and the reliability, quality, and price of international long distance services.

3.40 At the present moment, Uruguay compares unfavorably in terms of price with the telecommunications services offered by leading free zone-sponsoring countries. Telecommunications services in Uruguay are provided by ANTEL, a state-owned monopoly. The service

is relatively reliable but costly, providing direct international dialing from nearly all of the population centers of the country. The telex services also are provided through ANTEL, although there are private businesses which sell, rent and install equipment. There are few difficulties in obtaining telex lines, but the shortfalls in standard telecommunications lines, including facsimile, sometimes result in delays of several months in areas where the existing system is nearing saturation. Internal telecommunications systems are of a lower quality than are international services.

3.41 Prices for international dialup services between Uruguay and New York City are now US\$ 4.24/minute. Dedicated leased analog voice/data lines (9.6 kilobits/second) are also available through Antel, but at a price of approximately \$3000/month. These rates discourage many types of telecommunications-intensive service activities. In such cases as the San Isidro Free Zone of the Dominican Republic, by contrast, higher quality 64 kbs lines are available to the United States at monthly rates of \$1850 a month. Even with full amortization of \$75,000 earth station and \$25,000 in multiplexing equipment over a five-year period, four dedicated digital voice circuits can be made available under such an alternative private system for as little as \$850/month.

3.42 Despite the present service limitations, Uruguay is in a potentially advantageous position vis a vis competitors due to the demonopolization of utilities provided for by the recently amended free zone legislation. As discussed in the following chapter, the decision to allow private alternatives to the previously complete ANTEL service monopoly means that internationally competitive prices and service quality may be available to free zone users in the near (nine- to twelve-month) future.

3.43 *Power.* Affordable and dependable power supplies are also essential for successful free zone operations, particularly in the case of companies relying upon continuous production lines. The electricity/power systems in Uruguay are part of a network established by UTE, a public sector monopoly which provides almost all of the country's energy, with the exception of the hydro-electrical operation. The rates for electricity are established every three months by the Government -- as are the rates for water, telecommunications, and fuel. The rates are the same for the entirety of the country, although different rates are charged for industrial, commercial and residential consumers.

3.44 As of 1988, power rates available through UTE were as follows:

Commercial

Monthly Fixed Cost: US\$ 4.80

Variable Cost: US\$ 0.07 per KWh for consumption
between 1-1000 KWh;
US\$0.09 per KWh for consumption
over 1000 KWh/month.

Industrial

Monthly Fixed Cost: US\$ 5.75

Variable Cost: US\$ 0.06 per KWh for consumption
between 1-10,000 KWh/month;
US\$ 0.05 per KWh for consumption
between 10,000-50,000 KWh/month.

3.45 These rates compare favorably to those found in other free zones of the hemisphere. To the extent that any problems in obtaining power are encountered by industries, the exemption of Uruguayan free zones from public sector monopolies makes it possible for private alternatives to be arranged.

3.46 *Water/Sewer.* The water and sewage service is provided throughout the country by a state owned monopoly -- OSE. The network of potable water provision is good, providing service to more than 85 percent of the homes, with generally a high-quality product. The sanitation system is less extensive, with some problems of contamination in those areas of final discharge.

3.47 *Roads and Railroads.* Uruguay has a network of more than 5,000 kms of paved concrete and asphalt roads. The systems extends radially from Montevideo and suffers from a lack of interconnections outside that city. In addition, there are also 40,000 kms. of secondary roads of variable quality, many of which are rendered impassable during the rainy season. There are several overland entry points on major highways linking Uruguay with Argentina and Brazil. The railroad network is laid out in similar manner to the highway network but is less extensive at 2,993 kms and, as already mentioned, it has been dedicated since 1986 exclusively to cargo transport. A railroad connection with Argentina is in place at Salto Grande.

3.48 *Ports and Airports.* As areas directly linked to the world economy, free zones rely upon international air and/or ocean freight services. The absence of affordable, reliable freight services can be a prohibitive barrier to near-term free zone success. Most successful zones, accordingly, are situated near an established international air or sea port, or linked by excellent internal road or rail networks to such facilities. In this light, the high cost of international cargo transport from Uruguay, as discussed above, is an obstacle to the development of zone activity.

3.49 The country's major port is in Montevideo, which is the only facility equipped to handle offshore carriers. Due to the high cost of dredging, the present maximum depth of the channels to the port is 11 meter. Interest has been expressed in developing alternative deep-water ports in Uruguay; if given free zone status, the ports adjacent to the existing free zones at Colonia or Nueva Palmira could be privatized, as could the port serving Fray Bentos, a potential new free zone site.

3.50 The International Airport of Carrasco is the only active international airport in the country. Carrasco is located approximately 18 kms from Montevideo and is accessible via area highways. An alternative facility exists in the district of Durazno, but has severe infrastructure limitations and serves only as an emergency landing area.

3. Assistance Programs

3.51 *Specialized Training.* There are two polytechnic schools at the university level in Uruguay: the University of Labor -- a public institution -- and the private Institute Organization for Rehabilitation and Training (ORT), where in addition to various technical and information services programs being offered, the country's first management school has been established. A government organization, the Technological Laboratory of Uruguay (LATU), also plays an important role in the control of the quality of exports, monitoring the activities and products of export industries.

3.52 *Below-Market Financing.* The concessional credit facilities presently available to export industries are as follows:

- Credit offered to projects declared to be in the "National Interest" according to the Industrial Promotion Law, provided via the Central Bank, the Investment Development Fund, and the National Preinvestment Fund.
- Concessional credit channeled through the Central Bank from other sources, including foreign institutions. In addition, the Central Bank has its own concessional credit lines, created with its own resources.
- Lines of credit and loans from government to government are provided through institutions of international cooperation, which are generally administered through the Office of Planning and Budget.

3.53 *Debt/Equity Swap Preference.* Each year a solicitation is made for presentation of projects which seek to convert debt into equity. The Central Bank studies the different proposals presented and according to priorities established by the Government undertakes the selection of the projects to be approved. In 1989, the Bank undertook the second solicitation under this system for an amount of up to US\$15 million. In contrast to other countries offering free zones, however, no debt conversions have been provided yet in Uruguay to support private zone developers or users.

4. Stability of Investment Climate

3.54 *Personal Safety for Business Personnel.* For businesses and their employees, Uruguay offers a completely tranquil environment.

For over more than 15 years, there has not been one case of internal or external violence against resident businesses by unions, subversives, organized crime, or other organized bodies.

3.55 *Respect for Business Property and Contracts.* The Government of Uruguay has a history of respecting property and contractual rights. The Uruguayan judicial system adheres to the precepts of accepted international commercial law. Likewise, Uruguay has extensive, longstanding legislation regarding international intellectual and property rights, as summarized below.

3.56 *International Copyright and Patent Safeguards.* Decree No. 9927 of 1937 protects the rights of an author or inventor in the fields of science and art for a period extending until forty years after their death. Intellectual rights can be freely assigned and transferred with the exception of "personal" rights, such as being cited as the author of a publication. Rights of authorship extend to computer software.

3.57 In the area of trademarks, Decree No. 9956 of 1940 protects the rights of those that register commercial or service trademarks for a period of up to ten years following registration. Uruguay is a signatory of the original Paris Convention regarding Industrial Property, but has not ratified its amendments.

3.58 Regarding patents and industrial designs, Decree No. 10089 of 1941 protects the rights of inventors of new products or industrial innovations for a period of 15 years. If the patent has not been effectively utilized in the country during the last three years, a license can be extended to third parties. Decree No. 14.549 of 1976 protects authorship rights over industrial design, not covered under the patent law, for a period of up to ten years.

3.59 Finally, Decree No. 10079 of November 1941 allows the Executive power to grant whatever person or entity the exclusive right to develop or apply new industrial processes, during a period of nine years. This statute has not been utilized in recent years.

3.60 *Investment Guarantees.* The present economic policy of Uruguay reflects the general change in orientation undertaken in 1974. The central element of its financial policy is the maintenance of a free exchange market, accompanied by a complete freedom in the circulation of hard currency; free repatriation of capital and earnings of businesses is perpetually guaranteed, regardless of what future economic policy might be. The banking sector is legal bound to adhere to these precepts. The 1974 Foreign Investment Law sets forth a framework by which the State will contract with a foreign investor to guarantee the free convertibility and repatriation of capital and the earnings of the business. The degree of confidence of the foreign business community in Uruguay is such that this law has since fallen into disuse.

3.61 *Quality of Dispute Resolution.* The Uruguayan judicial system

has been markedly resistant to internal pressures and influence -- economic, political or otherwise -- but has not overcome an inveterate defect in its operations: the extremely lengthy period required to arrive at a judgement. A lack of confidence in the system as an effective means of resolution of disputes has thus resulted, with many electing to settle out of court.

5. Living Conditions for Expatriates

3.62 In their early stages, free zone companies often bring in a significant number of foreign nationals to staff key managerial and technical positions. These expatriates tend to be sensitive to the types and quality of housing, health care, crime, schooling, and recreation for themselves and their families. Zones that do well in making expatriates and their families feel comfortable enjoy a significant competitive advantage over zones that present more difficult living conditions. (Over time, however, the importance of these factors tends to recede, as local managers and technical professionals advance within free zone companies and as indigenously-owned subcontracting operations take root within zones.)

3.63 At present, particularly in Montevideo and in such areas as Punta del Este, Uruguay has few rivals in Latin America regarding the general quality of living conditions offered to expatriates.

Housing. Montevideo and Punta del Este offer ample alternatives in terms of housing both in the quality of housing and the relative availability of housing. Colonia also possesses a limited supply of high-quality residences. The prices for housing vary greatly, but as an indicator, a two-bedroom apartment in a residential area of Montevideo will rent for approximately US\$350/month. The price and quality of housing elsewhere depends on the region and neighborhood under consideration, as is discussed in Annex C.

Health Services. Health services in Uruguay are comparable to those available in the United States, but at a lower cost for clinics or out-patient services. For more sophisticated treatment, however, there are certain limitations in equipment.

Education. The supply of educational institutions in Montevideo is substantial and the cost is accessible -- US\$100-200/month for private institutions. There are also colleges which offer foreign language programs. In the rest of the country, however, the supply of educational institutions for expatriates and their families is noticeably lower.

Cultural Amenities/Recreation. Montevideo is a city with a substantial cultural life, especially in terms of the theatre, but there are certain gaps relative to Buenos Aires

which offers a much broader cultural spectrum. Elsewhere in the country cultural amenities are much more limited. In terms of recreation, Uruguay has 800 kms of beaches, including the internationally renowned Punta del Este. Hunting, fishing, hiking, and other recreational activities are available throughout the interior of the country.

6. Access to Regional Markets

3.64 Beyond its geographic proximity to major export markets, Uruguay enjoys relative unencumbered access to them as a result of a network of favorable trade agreements, which have removed many traditional obstacles to free access. Under the Sanguinetti Administration, trade agreements have achieved across-the-board tariff exemptions for many Uruguayan products sold to Argentina (until a 5 percent penetration rate is reached), and a Commercial Expansion Protocol with Brazil has provided similar tangible opportunities. (The implications of these multilateral and bilateral trade agreements for Uruguayan free zones are summarized below, and discussed more fully in a separate Spanish-language supplement to this report.)

3.65 *Multilateral Agreement: Latin American Integration Association (ALADI)*. In recent years, the Government of Uruguay has made a concerted effort to enhance trade relations with the countries of the southern cone. A major step in that direction was taken in 1980 with the signing of the "Montevideo Agreement," by Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela in August 1980 and enacted by Uruguay through Law No. 15.071 in October 1980. In accordance with its precepts, the member countries established a preferential tariff area within which agreements of regional and sub-regional scope have been enacted.

3.66 The agreements of regional scope are those in which all the member nations listed above participate. These include the Regional Preferential Tariff (PAR) agreement (1984), by which the signatories are afforded preferential treatment over reciprocal imports. This consists of a percentage reduction of (or complete exemption from) the duties applied to the imports from countries within the region, with the exception of those products expressly excluded in writing.

3.67 The PAR was modified by the member countries in 1987, ascribing new preferential tariff rates keyed to the level of economic development of the exporting and importing countries. The categorization established was as follows: (i) Less developed countries (relative to the other signatories); (ii) countries of intermediate development; and (iii) other countries. Under this classification system, Uruguay is classified as a country of "intermediate development." The tariff rates in force range from a low of 4 percent duties levied against exports from LDCs (i) to "other countries" (iii), to 20 percent for the reverse situation. This protocol also established finite ceilings on the number of

product categories that can be excluded from preferential treatment under the PAR, according to the same classification system. LDCs were ascribed a limit of 2,400 excluded items; intermediate, 1,200; and other members, 600.

3.68 As a result of the Montevideo agreement and subsequent negotiations, Uruguay is now party to eight regional agreements, seven bilateral agreements, and one agreement with five signatories. These agreements have had a profound impact on regional trade patterns in recent years. Key bilateral treaties are discussed below.

3.69 *Bilateral Agreements.* Within the ALADI framework, several bilateral agreements have been enacted that serve to reduce the trade barriers between the signatories. For Uruguay, the most important of these include the following:

CAUCE. The Convenio Argentina-Uruguay de Cooperacion Economica (CAUCE) was originally drafted and authorized in 1974 as a means to equalize the volume of trade between Uruguay and Argentina, which had historically enjoyed a healthy trade surplus. As structured, both countries agreed to eliminate duties and other restrictions on trade in certain products. In the initial years of its application (1975-1982) the CAUCE had a profound impact on trade between the two countries, to the extent that in 1982 and 1983, Uruguay achieved a trade surplus with Argentina. However, between 1982 and 1985, the program suffered from a failure to re-examine and renegotiate the list of exempted products to reflect new market realities.

To address these shortcomings, the modified agreement currently in force was signed in 1985 (the "Colonia Act") and represents a major advance in the trade relations between the two countries. As revised, the CAUCE liberalized the determination procedures for certificates of origin and broadened the impact of the agreement on Uruguayan exports. In essence, the agreement provides for duty-free entry of a wide range of Uruguayan exports to Argentina until the volume of such products equals up to 5 percent of total Argentine production. Product categories deemed "sensitive" are limited to 2.5 percent ceiling, and in special, "critical," cases certain products may be subject to individual bilateral agreements. In terms of Argentine exports to Uruguay, the CAUCE eliminates Uruguayan duties on capital goods imports that are not locally produced.

As of November 1988, 3,110 Uruguayan items were included under the CAUCE agreement. Problems have arisen in the quantification of the Uruguayan export volume accorded the benefits. At times the Argentine government has unilaterally determined the 5 percent (or 2.5 percent) level. There are numerous items for which the quantified quota level falls far short of the actual percentage. Over 200 items are now close

to reaching their quota limitations (between 90 and 100%), including many dairy products and agricultural goods, plastics, paints, paper goods, electrical components, etc.

PEC. The Commercial Expansion Protocol, or "PEC" is a reciprocal trade agreement between Uruguay and Brazil providing preferential market access for specified exports. Based on a bilateral trade agreement of 1975, the current program was enacted in 1986, with new products added to the list of preferential goods in 1988.

Under the PEC, each product must be negotiated separately, item by item, for inclusion in the program. Approved Uruguayan exports are separated into seven classifications with accompanying US\$ ceilings ranging from US\$300,000 (Category "1") to US\$5 million (5). For certain goods (6) volume ceiling are specified or individual US\$ ceiling defined; other items (7) are not subject to any limitations in either volume or value. Entry to the Brazilian market for Uruguayan exports which exceed these ceilings is not automatically restricted, however, Brazilian officials have the authority to do so. The US\$ ceilings are adjusted each year to maintain a constant value. In addition, a mechanism exists whereby the limits for an item are automatically readjusted to the next highest level (for example from Category 2 [US\$500,000] to Category 3 [US\$1 million]) when the value of the Uruguayan exports maintains an average of 90 percent of the establish limit for three consecutive years.

As presently constructed, the PEC has raised quota levels for Uruguayan exports to Brazil in key export categories such as dairy products, meat and rice. At present, less than 25 percent of the Uruguayan exports to Brazil classified under the PEC have exceeded 50 percent of the US\$ ceilings. In return, Brazilian capital goods and equipment receive preferential tariff treatment for entry into the Uruguayan market if they are not presently produced in Uruguay. Over the past four years, Brazil has replaced the United States as Uruguay's principle trading partner, in 1987 receiving over \$204 million in Uruguayan exports and accounting for close to US\$280 million in imports. However, the declining economic conditions in Brazil pose a threat to the continued expansion of commercial ties between the two countries.

Uruguay-Mexico Economic Agreement. Originally signed in May 1986, the scope of this trade agreement between Uruguay and Mexico was substantially broadened in 1987 and 1988. Under the program, Mexico reduced or eliminated duties and non-tariff barriers to Uruguayan exports for over 90 percent of the items included in the Mexican Tariff Schedule. At present, the list of excluded items numbers 708 products out of a total of 7,800 product categories. In those cases where duty-free imports might threaten national production of a product with significant importance to the economy or

destablize the trade balance, the exemption can be suspended for a period of one year, renewable for two additional years.

The agreement covers Uruguayan commodity exports and processed goods, as well as goods originating in third countries that have been substantially transformed in Uruguay to the extent that they are re-classified as a new product category or at least 50 percent of the CIF value of the product is derived in Uruguay.

3.70 The impact of the regional trade agreements on Uruguayan exports has varied according to the specific program and the variations in the respective economies. For the most part, the regional agreements have been effectively administered by the Uruguayan government but have, in some instances, suffered from a lack of clarity in the definition of key concepts in its implementation by signatory governments. Specifically, the distinction between "industrial" and "agricultural" ("agropecuaria" which includes ranching) activity is blurred within the ALADI nomenclature sometimes resulting in disagreements with regard to quota allocations, certificates of origin, and the like. For the most part, this terminology has been clarified in the bilateral agreements through more precise definitions. Problems have also arisen in assigning the products classified under the specific inter-country agreements to the items listed under the ALADI classification. Some ALADI items cover as many as 20 or thirty products, which must each be individually specified (and negotiated) in the bilateral and sub-regional agreements.

3.71 Likewise, in the CAUCE agreement with Argentina, Uruguay has encountered problems with the definition of "Argentine production," the founding element of the 5 percent quota on the duty-free exports to that country. There are disagreements as to what exactly should be included in this figure, the impact of exports and imports, the relationship of intermediate good exports on the quota levels for finished goods, etc. Also, the accuracy of the data from which "national production" is determined is often imprecise, resulting in product-by-product negotiations between the two countries. Given these procedural difficulties, for Uruguayan free zone industries wishing to avail themselves of the CAUCE, it is recommended that the firm request from the Uruguayan authorities the following information: (i) whether their product has been quantified by Argentina and the utilization of the quota; and (ii) if the product has not been quantified, request the quantification as part of its market analysis.

3.72 Unlike the agreements with Argentina and Mexico, the PEC agreement operates on a product by product basis, subject to bilateral negotiations between Uruguay and Brazil. Thus far, the program has been operated pragmatically, and as modified in 1986, has become more automatic in its implementation and has contributed to a substantial increase in Uruguayan exports to Brazil. Nevertheless, substantial opportunities still exist for greatly increased exports in the near totality of the product categories.

3.73 With regard to the Uruguayan-Mexican trade agreement, given that it is only two years old, the impact upon bilateral trade remains difficult to quantify. However, it is clear that there has been an increase in Uruguayan exports to Mexico, but no discernable diversification in the products exported. The only obstacle encountered resides in the generally low levels of duties applied by Mexico to foreign imports. Therefore, the duty relief enjoyed by Uruguay provides only a marginal advantage over the much more sophisticated trade inflow to Mexico from the United States.

7. Access to International Markets

3.74 Uruguay is a member of the General Agreement on Tariffs and Trade (GATT) a multilateral treaty intended to liberalize international trade and trade practices, and eliminate protectionist barriers to the free exchange of goods. Under GATT, specified Uruguayan exports are given duty relief for entry into international markets.

3.75 In addition, Uruguay is a beneficiary of the Generalized System of Preferences (GSP), a trade arrangement by which developed countries offer preferential access to LDC exports principally for manufactured or assembled products, processed in the beneficiary countries. Developed country members include the EEC, United States, Switzerland, Austria, Norway, Japan, Canada, and Australia, among others. The nature of the benefits offered and the regulations regarding their application vary from country to country. In the United States, for example, Uruguay can export a wide variety of products (over 3,000 categories) completely duty-free. In order to qualify under the program, the goods must be either wholly made in the exporting country or the sum of (i) the cost or value of the material produced in the developing country and (ii) the direct costs of processing operations performed there must be at least 35 percent of the appraised value of the merchandise.

C. SECTORS WITH INTRINSIC POTENTIAL FOR URUGUAYAN FREE ZONES

1. Methodology for Assessing Sector Potential

3.76 Any rigorous evaluation of business feasibility for a given industrial or service sector requires gathering of highly-detailed, country-specific cost data for a typical enterprise in that sector. When multiple sectors and multiple countries are included in the scope of the assessment, the complexity of the task grows geometrically.

3.77 The sector assessments that have been conducted in the course of this study provide for a preliminary determination of the potential viability of the industries examined, along with the competitive position of Uruguay vis a vis key competitors. At an

opportunity identification level of analysis, general conclusions can be drawn as to whether an industrial activity is potentially profitable based on data regarding the availability and cost of key production factors. Accordingly, the project team concentrated on data collection in three critical areas -- labor, freight, and telecommunications -- for firms locating a range of existing and potential free zone locations in Uruguay. Concurrently, information was gathered regarding factor endowments and costs in the leading alternative offshore location for each industry sector. The sectors examined included apparel, electronics, agro-processing, as well as a variety of emerging information services activities.

3.78 The tables presented on the following pages are intended as a basis for comparison on two distinct levels. They provide community/region-specific information on alternative locations within Uruguay -- Montevideo, Punta del Este, Fray Bentos, etc., as well as an indication of how the Uruguayan potential zone locations compare to regional competitors and U.S.-based operations. Preliminary judgements are then made as to the desirability of a specific Uruguayan free zone site as an investment location for firms in that industry. The assessments made are oriented toward industrial and service exports to the U.S. market.

3.79 As is shown on the following pages, it is important to note that the potential viability of several industries examined is directly linked to the development of new alternatives to the public sector services presently provided in Uruguay. For example in the informatics sector, a key element of locational analyses is the provision of international telecommunications services and facilities. The availability of cost-competitive, high-quality telecommunications links can be a make or break factor for this sector's development. For firms considering Uruguay as an investment location, the opportunity to develop and utilize such services exists only within the free zone framework and is one of the primary advantages Uruguay holds over offshore competitors, (although these opportunities today exist only as a legal statement rather than as an established alternative). Consequently, in addition to presenting the prevailing costs for telecommunications service under the ANTEL system, estimates have been made of the rates that can be expected by under privately sponsored telecommunications facilities and services.

2. Identification of Priority Sectors

a. Traditional Industry Sectors

3.80 *Potential for Apparel Operations.* As shown in Table III-1a, Uruguay stands to attract apparel assembly and textile operations, given the availability of natural fibers and affordable labor in the country, and the existence of unused quota allotments for export to the U.S. market. Because labor accounts for an average of 35 percent of an apparel product's value, North American firms

generally can save 15-20 percent by moving to locations such as Uruguay. For a typical apparel assembly operation, location in Uruguay would yield a substantial savings relative to a U.S.-based operation, although not as great as savings that can be realized in the Dominican Republic (largely due to labor cost differentials). The optimal market segments for Uruguay are products which utilize locally-produced wool fabrics, yarns, and leather, and which have high labor content to weight ratios, infrequent in-season reorders, decentralized cutting and parts preparation; low brand-name identification, and smaller production runs. High ocean and air freight costs work against the rapid development of this sector, as does competition from lower labor cost countries in Latin America. Nonetheless, Uruguay's stability, high skill levels, and established textile producers will incline a growing number of firms--particularly from the Far East--to explore investment in the country. Preferred sites for plant location will be near urban centers with an abundant female workforce and mid-level managers.

3.81 *Potential for Electronics Assembly Operations.* Uruguay appears to have limited potential to attract electronics industries oriented towards international markets, because of higher labor costs and transport costs relative to competitors (see Table III - 1b). The products most suited for offshore production, in general, are electronic components and subsassemblies and consumer electronics products. Within these segments, Uruguay appears to have greatest potential to attract producers whose products have high value to weight and price to volume ratios as well as short production runs, or which are destined principally for regional markets. (An example of an emerging high value-added subsector would be the design and production of Application Specific Integrated Chips, for very highly specialized control systems in consumer electronics and industrial products. Developing a specialization in the design of such chips on Computer-Aided Design equipment would give Uruguay an advantage, particularly as the price of ASIC fabrication systems is expected to drop to affordable levels for developing countries.)

3.82 *Potential for Food Processing Operations.* Access to a range of agricultural and maritime harvests positions Uruguay to be a strong competitor in selected food processing operations. Bulk and intermediate processing by local and regional firms appears possible for such items as meat, milk, fruits and vegetables, wheat, sugar, rice, poultry, soya, corn, and salt and fresh water fish. An assessment of one type of food processing operation -- production of fruit preserves -- confirms that sizable savings can be achieved by an operation in Uruguay relative to one in the United States. Competitors based in Manaus (Brazil), however, have the advantage of additional labor cost savings (Table III-1c). Consequently, Uruguayan zones should concentrate on food processing operations for which there are (a) price or quality advantages over competitors in access to the raw agricultural/maritime inputs; (b) freight savings in shipments to

Table III - 1a
TRADITIONAL FREE ZONE SECTOR ASSESSMENT MATRIX: APPAREL

Key Factors	Existing Uruguyan Zones		Potential Uruguyan Zones (Best Fit With Sector)			Prime Competitor
	Colonia	Nueva Palmira	Montevideo	Fray Bentos	Rio Branco	
PRODUCTION FACTORS						
Designated Site	Yes	Yes	No	No	No	Yes
Available Buildings	None Available	None Available	No	No	No	Within 4-6 months
Basic Labor Cost (w/fringes)	US\$ 1.32/hr	US\$ 1.32/hr	US\$ 1.32/hr	US\$ 1.32/hr	US\$ 1.32/hr	US\$.66/hr
Basic Labor Supply	Adequate	Adequate	Excellent	Adequate	Adequate	Excellent
Skilled Labor Cost (w/fringes)	US\$ 1.82/hr	US\$ 1.82/hr	US\$ 1.82/hr	US\$ 1.82/hr	US\$ 1.82/hr	US\$ 1.57/hr
Skilled Labor Supply	Marginal	Marginal	Excellent	Marginal	Marginal	Good
Air Freight (NY)	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.60 - \$.95 /lb
Ocean Freight (NY)	US \$3100	US \$3100	US \$3100	US \$3100	US \$3100	US\$ 1470
Ocean Freight (Regl Markets)	N/A	N/A	N/A	N/A	N/A	N/A
Trucking to Int'l Airport	220 km	310 km	Minimal	310 kms (Mont)	400 kms (Mont)	75 kms (S.Domingo)
Trucking to Ocean Port	Adjacent (Colonia)	1 km (Nueva Palmira)	Minimal	2 km (F. Bentos)	400 kms (Mont)	51 kms (Hana)
Telecommunications						
PTT dialup to US	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$.86/minute
PTT dedicated line to US	\$3000/month	\$3000/month	\$3000/month	\$3000/month	\$3000/month	\$3500/month
Alternative ded. line to US*	\$850/month	\$850/month	\$850/month	\$850/month	\$850/month	No alternative available
Other Utilities						
Water/Sewer	Poor	Poor	Very Good	Adequate	Adequate	Adequate
Power	Adequate	Adequate	Very Good	Adequate	Adequate	Marginal
Raw Materials./Int. Goods	Wool, leather	Wool, leather	Wool, leather	Wool, leather	Wool, leather	Leather
ACCESS TO MARKETS						
OECD countries	GSP	GSP	GSP	GSP	GSP	807, Super 807, GSP
Argentina	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	No Preference
Brazil	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	No Preference
QUALITY OF LIFE	Adequate	Adequate	Excellent	Adequate	Marginal	Excellent
CONCLUSION	Feasible Site For Argentine Market	Feasible Site For Argentine Market?	Prime Site For Upscale Products	Feasible Site For Argentine Market	Feasible Site For Brazilian Market	Unbeatable for Low-End U.S. Market Segments

*Not presently available, but legally authorized under the new Uruguay free zone law. Based on 16 kbs digital voice circuit assuming Pan American Satellite rates of \$1850/mo. per 64 kbs line between Montevideo-U.S. plus \$150,000 earth station with multiplexer fully amortized by the single 64 kbs line over five years.

Table III - 1b
TRADITIONAL FREE ZONE SECTOR ASSESSMENT MATRIX: ELECTRONICS

Key Factors	Existing Uruguyan Zones		Potential Uruguyan Zones (Best Fit With Sector)		Prime Competitor
	Colonia	Nueva Palmira	Montevideo	La Paloma/Rocha	
PRODUCTION FACTORS					
Designated Site	Yes	Yes	No	No	Yes
Available Buildings	None Available	None Available	No	No	Within 4-6 months
Basic Labor Cost (w/fringes)	US\$ 1.32/hr	US\$ 1.32/hr	US\$ 1.32/hr	US\$ 1.29/hr	US\$.74/hr
Basic Labor Supply	Adequate	Adequate	Excellent	Adequate	Excellent
Skilled Labor Cost (w/fringes)	US\$ 1.82/hr	US\$ 1.82/hr	US\$ 1.82/hr	US\$ 1.99/hr	US\$ 1.68/hr
Skilled Labor Supply	Marginal	Marginal	Excellent	Marginal	Good
Air Freight (NY)	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.60 - \$.95 /lb
Ocean Freight (NY)	US \$3100	US \$3100	US \$3100	US \$3100	US\$ 1470
Ocean Freight (Regl. Markets)	N/A	N/A	N/A	N/A	N/A
Trucking to Int'l. Airport	220 km	..10 km	Minimal	310 kms (Mont)	43 kms (S.Domingo)
Trucking to Ocean Port	Adjacent (Colonia)	1 km (Nueva Palmira)	Minimal	2 km (F. Bentos)	6 kms (Haina)
Telecommunications					
PTT dialup to US	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$.86/minute
PTT dedicated line to US	\$3000/month	\$3000/month	\$3000/month	\$3000/month	\$3500/month
Alternative ded. line to US*	\$850/month	\$850/month	\$850/month	\$850/month	No alternative available
Other Utilities					
Water/Sewer	Poor	Poor	Very Good	Very Good	Adequate
Power	Adequate	Adequate	Very Good	Very Good	Adequate
Raw Materials./Int. Goods	--	--	--	--	--
ACCESS TO MARKETS					
OECD countries	GSP	GSP	GSP	GSP	Carib. Basin Initiative
Argentina	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	No Preference
Brazil	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	No Preference
QUALITY OF LIFE	Adequate	Adequate	Excellent	Adequate	Excellent
CONCLUSION	Not Recommended	Not Recommended	Prime Site For Upscale Products	Secondary Uruguyan Site	Strong Competitor For Low-Middle U.S. Market Segments

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* Not presently available, but legally authorized under the new Uruguay free zone law. Based on 16 kbs digital voice circuit assuming Pan American Satellite rates of \$1850/mo. per 64 kbs line between Montevideo-U.S. plus \$150,000 earth station with multiplexer fully amortized by the single 64 kbs line over five years.

Table III - 1c
TRADITIONAL FREE ZONE SECTOR ASSESSMENT MATRIX: FRUITS/VEGETABLES PROCESSING

Key Factors	Existing Uruguyan Zones		Potential Uruguyan Zones (Best Fit With Sector)			Prime Competitor
	Colonia	Nueva Palmira	Fray Bentos	Bella Union	Rio Branco		Manaus (Brazil)
PRODUCTION FACTORS						
Designated Site	Yes	Yes	No	No	No	Yes
Available Buildings	None Available	None Available	No	No	No	Yes
Basic Labor Cost (w/fringes)	US\$ 1.32/hr	US\$ 1.32/hr	US\$ 1.32/hr	US\$ 1.32/hr	US\$ 1.32/hr	US\$.66
Basic Labor Supply	Adequate	Adequate	Adequate	Adequate	Adequate	Excellent
Skilled Labor Cost (w/fringes)	US\$ 1.82/hr	US\$ 1.82/hr	US\$ 1.82/hr	US\$ 1.82/hr	US\$ 1.82/hr	Current data unavail.
Skilled Labor Supply	Marginal	Marginal	Marginal	Marginal	Marginal	Good
Air Freight (NY)	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.70 - \$1.00 /lb
Ocean Freight (NY)	US \$3100	US \$3100	US \$3100	US \$3100	US \$3100	US\$ 3000
Ocean Freight (Regl. Markets)	N/A	N/A	N/A	N/A	N/A	N/A
Trucking to Int'l. Airport	220 km	310 km	310 kms (Mont)	400 kms (Mont)	630 kms (Mont)	Minimal
Trucking to Ocean Port	Adjacent (Colonia)	1 km (Nueva Palmira)	2 km (F. Bentos)	400 kms (Mont)	300 km (F. Ben)	Minimal
Telecommunications						
PTT dialup to US	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	Current data unavail.
PTT dedicated line to US	\$3000/month	\$3000/month	\$3000/month	\$3000/month	\$3000/month	Current data unavail.
Alternative ded. line to US*	\$850/month	\$850/month	\$850/month	\$850/month	\$850/month	No alternative permitted
Other Utilities						
Water/Sewer	Poor	Poor	Adequate	Adequate	Adequate	Adequate
Power	Adequate	Adequate	Adequate	Adequate	Adequate	Adequate
Raw Materials./Int. Goods	fruits/vegetables	fruits, vegetables	fruits,vegetables, soya	sugar, grapes, fruits/vegetables	fruits, vegetables, rice	Rice, beans, palm oil, nuts, flour, sugar
ACCESS TO MARKETS						
OECD countries	GSP	GSP	GSP	GSP	GSP	GSP
Argentina	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral
Brazil	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	ALADI, bilateral	Domestic Access
QUALITY OF LIFE	Adequate	Adequate	Adequate	Adequate	Marginal	Good
CONCLUSION	Feasible Site For Argentine Market	Feasible Site For Argentine Market	Feasible Site For Argentine Market	Feasible Site For Argentine Market	Feasible Site For S. Brazil Market	Best Bet for Major Brazilian Markets

*Not presently available, but legally authorized under the new Uruguay free zone law. Based on 16 kbs digital voice circuit assuming Pan American Satellite rates of \$1850/mo. per 64 kbs line between Montevideo-US plus \$150,000 earth station with multiplexer fully amortized by the single 64 kbs line over five years.

final markets (e.g. orienting export production to Argentine and South Brazilian consumers); and/or cyclical "windows" for export production, in which seasonal climatic constraints now keep competitors out of international markets.

3.83 *Potential for Commercial Operations.* A number of factors make Uruguay almost ideally positioned to provide warehousing/transshipment services to the regional market. Affordable ocean and land shipping costs to Argentina and Brazil, combined with favorable market access agreements, the stable business climate and the well-established banking system to make the country attractive as a storage and transshipment base. The Plate River basin serves as a natural gravitation area for agricultural and mineral commodities from the interior of the continent, and for their subsequent transshipment. Difficulties in accessing affordable international telecommunications and air passenger/freight services, particularly near Colonia, constitute the major current obstacles to growth in this sector.

b. Emerging Sectors

3.84 Certain new sectors such as information processing services have a close fit with Uruguayan factor endowments, given the human resources available at affordable prices in the country. A comparative analysis of telecommunications prices for informatics service exporters, however, indicates that potentials for certain sectors (notably fast-turnaround data entry, remote secretarial service, voice center operations, and client-interactive software services) will be greatly constrained if existing high telecommunications price levels in Uruguay are maintained.

3.85 *Potential for Data Entry/Office Support Services.* As shown in Table III-2a, Uruguay appears to have limited potential to attract traditional air freight-oriented data entry operations, given the intense competition from lower labor-cost countries located close to the United States. A typical data entry operation, while enjoying an average hourly direct labor cost savings of approximately US\$5 per worker relative to a U.S.-based operation, could not compete on price for slow-turnaround work with a location in the Dominican Republic, where labor costs for data entry operators are less than a third the going rate for Uruguay.

3.86 If private international telecommunications links at competitively priced levels are established in Uruguayan free zones, the country has a much stronger position to compete for *fast-turnaround* data entry operations (Table III-2b). First, the satellite communications links used for facsimile transmission of source materials to offshore locations are relatively distance-insensitive, in contrast to air freight services. Second, the higher interactivity with clients made possible through dedicated voice and data links enables more sophisticated operations to be performed offshore, thereby reducing the importance of Uruguay's (relatively higher) labor costs. Third, only one competitive zone--San Isidro in the Dominican Republic--at present has the

telecommunications infrastructure to compete with Uruguay's deregulated environment for teleport developers. Accordingly, Uruguay has unusual potential to profitably develop teleports for transmission of materials such as legal documents, financial publications, and virtually any other type of printed material to service bureaus, where the source documents can be keyed into data bases, edited, and/or summarized, and then returned to client within a matter of hours. (Remote secretarial services represent a similar high-potential market for development; tens of thousands of North American firms at present pay an average of US\$15,000 per secretary annually for office support, including a combination of word processing, transcription of dictated memo and letters, and telephone message-taking services.)

3.87 *Potential for Computer-Aided Design (Digitizing/Vectorizing).* The proliferation of CAD systems among U.S. firm has created a huge demand for converting paper documents into computer-readable format -- a labor-intensive "digitizing" process requiring an average of five hours per drawing. Because such conversion operations typically require extreme accuracy, operators and quality control procedures must be meticulous. Although offshore service bureaus, by virtue of their enormous labor cost savings, have the ability to afford more thorough-going levels of verification and quality assurance than their "on-shore" counterparts, the success of such service bureaus depends primarily upon the quantity and quality of drafting skills in the local workforce. Labor cost savings for Uruguayan CAD operators, relative to U.S. salaries, are in excess of US\$20,000 per year, and the technical capabilities of the urban labor force are more than adequate for digitizing and vectorizing. When compared to an operation in Trinidad in this sector, Uruguay appears well positioned in terms of labor costs to compete effectively.

3.88 *Potential for Software Services.* As shown in Table III-2d, Uruguay offers several strong advantages in the availability and cost of labor relative to Costa Rican free zones, which are targeting software exports to North America as a high growth market. An essential factor working to Uruguay's advantage is the potential for internationally priced telecommunications services, enabling offshore programmers to interact closely with clients in North America. Successful development of this sector on a large scale in any country, however, depends upon shifting training programs toward such operating systems and languages as UNIX, object oriented programming systems, C language, and hypertext/relational data base management systems. Practical experience is also valued by employers in business environments during the training periods, such as through internships or work/study arrangements, to supplement classroom training.

3.89 *Potential for Voice Center Operations.* In coming years, airlines, hotels, mail-order distributors, and related firms are expected to utilize the English and Spanish-language capabilities of countries in Latin America, especially to serve the growing Hispanic population in the U.S. Average salary differences between

Table III - 2a
EMERGING FREE ZONE SECTOR ASSESSMENT MATRIX: DATA ENTRY (SLOW)

Key Factors	Existing Uruguyan Zones		Potential Uruguyan Zones (Best Fit With Sector)		Prime Competitor
	Colonia	Nueva Palmira	Montevideo	La Paloma	
PRODUCTION FACTORS					
Designated Site	Yes	Yes	No	No	Yes
Available Buildings	None Available	None Available	No	No	Under construction
Basic Labor Cost (w/fringes)	US\$ 2.53/hr	US\$ 2.53/hr	US\$ 2.53/hr	US\$ 2.53/hr	US\$.64/hr
Basic Labor Supply	Adequate	Marginal	Excellent	Adequate	Excellent
Skilled Labor Cost (w/fringes)	N/A	N/A	N/A	N/A	US\$ 1.82/hr
Skilled Labor Supply	Inadequate	Inadequate	Excellent	Adequate	Good
Air Freight (NY)	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.60 - \$.95 /lb
Ocean Freight (NY)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Ocean Freight (Regl Markets)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Trucking to Int'l Airport	N/A	N/A	Minimal	N/A	Minimal
Trucking to Ocean Port	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Telecommunications					
PTT dialup to US	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$.86/minute
PTT dedicated line to US	\$3000/month	\$3000/month	\$3000/month	\$3000/month	\$3500/month
Alternative ded. line to US*	\$850/month	\$850/month	\$850/month	\$850/month	\$850/month
Other Utilities					
Water/Sewer	Poor	Poor	Very Good	Very Good	Adequate
Power	Adequate	Adequate	Very Good	Very Good	Marginal
Raw Materials./Int. Goods	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
ACCESS TO MARKETS					
OECD countries	No Preference	No Preference	No Preference	No Preference	No Preference
Argentina	No Preference	No Preference	No Preference	No Preference	No Preference
Brazil	No Preference	No Preference	No Preference	No Preference	No Preference
QUALITY OF LIFE	Adequate	Adequate	Excellent	Adequate	Excellent
CONCLUSION	Not Recommended	Not Recommended	Prime Uruguyan Site	Secondary Uruguyan Site	Unbeatable for Low-End Market Segments

* Not presently available, but legal authorized under the new Uruguay free zone law. Based on 16 kbs digital voice circuit assuming Pan American Satellite rates of \$1850/mo. per 64 kbs line between Montevideo-US plus \$150,000 earth station with multiplexer fully amortized by the single 64 kbs line over five years.

Table III - 2b
EMERGING FREE ZONE SECTOR ASSESSMENT MATRIX: DATA ENTRY (FAST)

Key Factors	Existing Uruguyan Zones		Potential Uruguyan Zones (Best Fit With Sector)		Prime Competitor
	Colonia	Nueva Palmira	Montevideo	La Paloma	
PRODUCTION FACTORS					San Isidro (D.R.)
Designated Site	Yes	Yes	No	No	Yes
Available Buildings	None Available	None Available	No	No	Under construction
Basic Labor Cost (w/iringes)	US\$ 2.53/hr	US\$ 2.53/hr	US\$ 2.53/hr	US\$ 2.53/hr	US\$.64/hr
Basic Labor Supply	Adequate	Marginal	Excellent	Adequate	Excellent
Skilled Labor Cost (w/iringes)	N/A	N/A	N/A	N/A	US\$ 1.82/hr
Skilled Labor Supply	Inadequate	Inadequate	Excellent	Adequate	Good
Air Freight (NY)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Ocean Freight (NY)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Ocean Freight (Regl. Markets)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Trucking to Int'l. Airport	N/A	N/A	Minimal	N/A	Minimal
Trucking to Ocean Port	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Telecommunications					
PTT dialup to US	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$.86/minute
PTT dedicated line to US	\$3000/month	\$3000/month	\$3000/month	\$3000/month	\$3500/month
Alternative ded. line to US*	\$850/month	\$850/month	\$850/month	\$850/month	\$850/month
Other Utilities					
Water/Sewer	Poor	Poor	Very Good	Very Good	Adequate
Power	Adequate	Adequate	Very Good	Very Good	Marginal
Raw Materials./Int. Goods	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
ACCESS TO MARKETS					
OECD countries	No Preference	No Preference	No Preference	No Preference	No Preference
Argentina	No Preference	No Preference	No Preference	No Preference	No Preference
Brazil	No Preference	No Preference	No Preference	No Preference	No Preference
QUALITY OF LIFE	Adequate	Adequate	Excellent	Adequate	Excellent
CONCLUSION	Not Recommended	Not Recommended	Prime Uruguyan Site	Secondary Uruguyan Site	Unbeatable for Low-End Market Segments

*Not presently available, but legally authorized under the new Uruguay free zone law. Based on 16 kbs digital voice circuit assuming Pan American Satellite rates of \$1850/mo. per 64 kbs line between Montevideo-U.S. plus \$150,000 earth station with multiplexer fully amortized by the single 64 kbs line over five years.

Table III - 2c
EMERGING FREE ZONE SECTOR ASSESSMENT MATRIX: COMPUTER AIDED DESIGN

Key Factors	Existing Uruguyan Zones		Potential Uruguyan Zones (Best Fit With Sector)		Prime Competitor
	Colonia	Nueva Palmira	Montevideo	La Paloma	
PRODUCTION FACTORS					Point Lisas (Trinidad)
Designated Site	Yes	Yes	No	No	Yes
Available Buildings	None Available	None Available	No	No	Under Construction
Basic Labor Cost (w/fringes)	US\$ 3.60/hr	US\$ 3.60/hr	US\$ 3.60/hr	US\$ 3.60/hr	US\$3.68/hr
Basic Labor Supply	Inadequate	Inadequate	Excellent	Marginal	Excellent
Skilled Labor Cost (w/fringes)	US\$ 4.98/hr	US\$ 4.98/hr	US\$4.98/hr	US\$4.98/hr	US\$5.09/hr
Skilled Labor Supply	Inadequate	Inadequate	Very Good	Marginal	Good
Air Freight (NY)	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.65-\$.82 /lb
Ocean Freight (NY)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Ocean Freight (Regl Markets)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Trucking to Int'l Airport	N/A	N/A	Marginal	N/A	Marginal
Trucking to Ocean Port	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Telecommunications					
PTT dialup to US	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$3.20/minute (est.)
PTT dedicated line to US	\$3000/month	\$3000/month	\$3000/month	\$3000/month	\$7000/month
Alternative ded. line to US*	\$ 850/month	\$ 850/month	\$ 850/month	\$ 850/month	Not Presently Permitted
Other Utilities					
Water/Sewer	Poor	Poor	Very Good	Very Good	Very Good
Power	Adequate	Adequate	Very Good	Very Good	Very Good
Raw Materials./Int. Goods	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
ACCESS TO MARKETS					
OECD countries	No Preference	No Preference	No Preference	No Preference	No Preference
Argentina	No Preference	No Preference	No Preference	No Preference	No Preference
Brazil	No Preference	No Preference	No Preference	No Preference	No Preference
QUALITY OF LIFE	Adequate	Adequate	Excellent	Adequate	Excellent
CONCLUSION	Not Recommended	Not Recommended	Prime Uruguyan Site With Teleport	Secondary Uruguyan Site With Teleport	Strong Competitor If Teleport Prices Are Low

* Not presently available, but legal authorized under the new Uruguay free zone law. Based on 16 kbs digital voice circuit assuming Pan American Satellite rates of \$1850/mo. per 64 kbs line between Montevideo-U.S., plus \$150,000 earth station with multiplexer fully amortized by the single 64 kbs line over five years.

Table III - 2d
EMERGING FREE ZONE SECTOR ASSESSMENT MATRIX: SOFTWARE SERVICES

Key Factors	Existing Uruguyan Zones		Potential Uruguyan Zones (Best Fit With Sector)		Prime Competitor
	Colonia	Nueva Palmira	Montevideo	La Paloma/Rocha		Cartago (Costa Rica)
PRODUCTION FACTORS					
Designated Site	Yes	Yes	No	No	Yes
Available Buildings	None Available	None Available	No	No	Yes
Basic Labor Cost (w/fringes)	US\$ 2.14/hr	US\$ 2.14/hr	US\$ 2.14/hr	US\$ 2.14/hr	US\$3.09/hr
Basic Labor Supply	Inadequate	Inadequate	Excellent	Marginal	Excellent
Skilled Labor Cost (w/fringes)	US\$ 3.60	US\$ 3.60	US\$ 3.60	US\$ 3.60	US\$3.86/hr
Skilled Labor Supply	Inadequate	Inadequate	Excellent	Adequate	Good
Air Freight (NY)	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.62 - \$.96 /lb
Ocean Freight (NY)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Ocean Freight (Regl Markets)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Trucking to Int'l Airport	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Trucking to Ocean Port	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Telecommunications					
PTT dialup to US	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$.81/minute
PTT dedicated line to US	\$3000/month	\$3000/month	\$3000/month	\$3000/month	\$3500/month
Alternative ded. line to US*	\$850/month	\$850/month	\$850/month	\$850/month	Not Presently Permitted
Other Utilities					
Water/Sewer	Poor	Poor	Very Good	Very Good	Very Good
Power	Adequate	Adequate	Very Good	Very Good	Very Good
Raw Materials./Int. Goods	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
ACCESS TO MARKETS					
OECD countries	No Preference	No Preference	No Preference	No Preference	No Preference
Argentina	No Preference	No Preference	No Preference	No Preference	No Preference
Brazil	No Preference	No Preference	No Preference	No Preference	No Preference
QUALITY OF LIFE	Adequate	Adequate	Excellent	Adequate	Excellent
CONCLUSION	Not Recommended	Not Recommended	Prime Uruguyan Site With Teleport	Secondary Uruguyan Site With Teleport	Strong Competitor If Teleport Prices Are Low

* Not presently available, but legally authorized under the new Uruguay free zone law. Based on 16 kbs digital voice circuit assuming Pan American Satellite rates of \$1850/mo. per 64 kbs line between Montevideo-U.S. plus \$150,000 earth station with multiplexer fully amortized by the single 64 kbs line over five years.

Table III - 2e
EMERGING FREE ZONE SECTOR ASSESSMENT MATRIX: VOICE OPERATOR CENTER

Key Factors	Existing Uruguyan Zones		Potential Uruguyan Zones (Best Fit With Sector)		Prime Competitor
	Colonia	Nueva Palmira	Montevideo	La Paloma	
PRODUCTION FACTORS	Colonia	Nueva Palmira	Montevideo	La Paloma	San Isidro (D.R.)
Designated Site	Yes	Yes	No	No	Yes
Available Buildings	None Available	None Available	No	No	Under construction
Basic Labor Cost (w/fringes)	US\$1.30/hr	US\$1.30/hr	US\$1.30/hr	US\$1.30/hr	US\$.64/hr
Basic Labor Supply	Adequate	Marginal	Excellent	Adequate	Excellent
Skilled Labor Cost (w/fringes)	N/A	N/A	N/A	N/A	US\$ 1.82/hr
Skilled Labor Supply	Inadequate	Inadequate	Excellent	Adequate	Good
Air Freight (NY)	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.75 - \$1.10 /lb	\$.60 - \$.95 /lb
Ocean Freight (NY)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Ocean Freight (Regl. Markets)	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Trucking to Int'l. Airport	N/A	N/A	Minimal	N/A	Minimal
Trucking to Ocean Port	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
Telecommunications					
PTT dialup to US	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$4.24/minute	\$.86/minute
PTT dedicated line to US	\$3000/month	\$3000/month	\$3000/month	\$3000/month	\$3500/month
Alternative ded. line to US*	\$850/month	\$850/month	\$850/month	\$850/month	\$850/month
Other Utilities					
Water/Sewer	Poor	Poor	Very Good	Very Good	Adequate
Power	Adequate	Adequate	Very Good	Very Good	Marginal
Raw Materials./Int. Goods	Inapplicable	Inapplicable	Inapplicable	Inapplicable	Inapplicable
ACCESS TO MARKETS					
OECD countries	No Preference	No Preference	No Preference	No Preference	No Preference
Argentina	No Preference	No Preference	No Preference	No Preference	No Preference
Brazil	No Preference	No Preference	No Preference	No Preference	No Preference
QUALITY OF LIFE	Adequate	Adequate	Excellent	Adequate	Excellent
CONCLUSION	Not Recommended	Not Recommended	Prime Uruguyan Site	Secondary Uruguyan Site	Unbeatable for Low-End Market Segments

* Not presently available, but legal authorized under the new Uruguay free zone law. Based on 16 kbs digital voice circuit assuming Pan American Satellite rates of \$1850/mo. per 64 kbs line between Montevideo-US, plus \$150,000 earth station with multiplexer fully amortized by the single 64 kbs line over five years.

bilingual operators in the U.S. and bilingual counterparts in Uruguay are more than \$10,000 annually. As shown in Table III-2e, Uruguay's competitiveness appears to be handicapped somewhat given the additional labor cost savings possible at the San Isidro (Dominican Republic) Free Zone. Nonetheless, the higher levels of education and training among Uruguayan workers should make it possible for Uruguayan voice centers to attract the middle to higher end of the Spanish-speaking operator services market. The feasibility of such voice center operations rests upon the prices charged for dedicated two-way international voice/data lines; the Pan American Satellite rate of US\$1850/month per 64 kilobits/second full duplex clear channel is used with the assumption of multiplexing four 16 kilobits/second voice lines. Besides holding telecommunications prices to world market levels, the success of countries in developing voice center operations will be proportional to their success in promoting excellent English as well as Spanish language skills in the workforce.

3.90 *Summary of sectoral analysis.* Uruguay has potential to establish a strong presence in meeting the growing international demand both for high-quality industrial and informatics exports, by virtue of its human resources, political stability, favorable free zone incentive policies, and large pool of bilingual people. While Uruguayan free zones can offer clear advantages relative to U.S. operations for every sector examined, Uruguayan labor costs and freight costs are sure to handicap the country's competitiveness in almost all of the "low end" industrial and service sectors examined, relative to other free zones in the region. Rather than compete for labor-intensive operations, it appears that Uruguay's comparative advantages are (a) with "up-market", knowledge-intensive operations (especially with a high level of telecommunications intensity under privately-provided systems), (b) resource-based processing operations, and (c) products eligible for access to regional markets under preferential trade agreements.

3. Identification of Priority Uruguayan Regions for Zone Development

3.91 Sectors suited for development in Uruguay varied substantially in accordance with the geographic area examined (see Annex C). Commercial operations appear to be viable for the existing free zones, as well as for Fray Bentos (for Argentine trade) and Rio Branco (for Brazilian trade). Food processing seems feasible for the existing zones, for Fray Bentos, and for both Bella Union and Rio Branco in the case of fruit/vegetable products; for fish processing, La Paloma/Rocha appears to be best suited.

3.92 As suggested by the tables presented earlier in this chapter, technology-intensive industrial and service sector operations oriented toward North American markets are unequivocally best suited not for existing free zone sites, but for prospective new zones in Montevideo and possibly La

Paloma/Rocha--provided that internationally competitive teleports are developed for informatics sectors. One location--Punta del Este--was not recommended for free zone development of any sort, given the high labor costs and the possibility that certain capital-intensive operations (such as some types of food processing) could negatively affect tourism in the area.

a. Existing Zones

3.93 *Colonia*. The Plate River estuary where Colonia is located brings special advantages to commercial operations serving regional markets. Colonia is a prime base for warehousing and processing of goods with origins or destinations in Buenos Aires. Given the high costs of ocean freight rates (approximately US\$3100 a container from Uruguay to New York), and the relatively small workforce available in the surrounding area, it is expected that Colonia will continue to serve principally an entrepot function, although industrial producers there could be successful in penetrating regional markets.

3.94 *Nueva Palmira*. At this zone, clear opportunities exist for both bulk shipment and processing of agricultural goods such as soybeans and produce from the Plate River Basin and from surrounding areas. Leather and meat processing operations seem to have similar potentials. The port benefits from its position as the most northerly meeting point in Uruguay for both river and ocean-going vessels. Because of the limited working population in the surrounding area, it is likely that industrial development in Nueva Palmira, like Colonia, will focus on capital-intensive operations such as agro-processing and pharmaceuticals, in addition to commercial/warehousing activities.

b. Potential Zones

3.95 *Montevideo*. More skill-intensive assembly and light manufacturing operations are best suited for the Montevideo metropolitan area, which has an economically active population of more than 580,000 and unparalleled access within the country to international air and ocean transportation. An industrial park-style zone oriented toward labor-intensive operations will be more successful here than elsewhere in the country. In addition, Montevideo holds the prime position in Uruguay for production of informatics exports. Given affordably priced dedicated international communications links, the human resource endowments in the metropolitan area could be readily accessible to North American markets for information processing services. In contrast to an industrial park-style zone, which would best be located near an international port and/or airport, an office property for informatics can be most feasibly sited near concentrations of specialized technical talent, including universities or downtown areas known for the prevalence of computer specialists and design professionals.

3.96 *La Paloma/Rocha*. Fish processing (and possibly repair/refueling for foreign fishing fleets) has apparent potential in the general area of La Paloma/Rocha. In addition, the population of 24,015 in Rocha represents a possible pool from which to draw labor for assembly/light manufacturing and informatics operations. The La Paloma/Rocha growth pole is relatively well favored for skill-intensive operations, given the presence of a branch of the University of Labor for technical training.

3.97 *Fray Bentos*. At present, Fray Bentos is a heavily rural and agriculturally based economy, although one with exceptional access via trucking services to the Argentine market. With an economically active population of about 12,000, it appears to have good potential for a variety of non labor-intensive operations, including processing of juices, leather hides, resins, and lumber.

3.98 *Bella Union*. A thriving horticultural sector is found at Bella Union, located at the northwestern corner of Uruguay. Its products -- tomatoes, peppers, and strawberries, as well as sugar cane and grapes -- lend themselves to downstream processing. With a fast-growing population of 17,000 residents -- many of whom have migrated to the area because of good economic opportunities -- the unemployment rate at present is low, and infrastructure has been overstrained in certain respects. Rail links to Montevideo appear to be the most feasible means of transporting goods.

3.99 *Rio Branco*. Like Fray Bentos vis a vis Argentina, Rio Branco is a strategic overland gateway to Brazil. The proximity of the community to Brazil makes it highly suitable for producers who are oriented to this market, and who can make use of meat, wool, and dairy products, or of locally grown vegetables and fruits. The population has grown at a rate ten times higher than the national average over the past 15 years, providing employers with an increasing pool of labor.

3.100 *Punta del Este/Maldonado*. A final growth pole examined by the project team consists of Punta del Este and the neighboring community of Maldonado. Although favored by a high quality of life, and by proximity to a good supply of beef and dairy products, the effects of the tourism industry upon labor and land prices make it unlikely that free zone industries would select this location over the alternatives already mentioned.

* * *

3.101 The project team had an opportunity to explore first-hand specific proposed free zone sites in several of the above "growth poles." Two of these were located in Montevideo, and one in Fray Bentos. (Key aspects of these projects are presented in Annex D, along with a matrix indicating their respective advantages and disadvantages.) From an economic perspective, all three appear to have good potential for complementary export-oriented initiatives:

the proposed "Services Free Zone" (for informatics), the potential "Montevideo Zona Franca" (for labor intensive industrial as well as commercial operations), and the "Parque Industrial Fray Bentos" (for processing of Plate River Basin goods for the Argentine market). Although time did not permit site visits in other locations, Rio Branco and Bella Union appear to have excellent prospects for horticultural and fruit processing, among other agroindustries. In addition, a zone in La Paloma/Rocha may be worth considering as an alternative to Montevideo for informatics exports into world markets, although it is decidedly a less suitable location for this purpose.

3.102 In choosing which of the above locations may warrant priority attention, the most important factor should be the quality and commitment of the prospective zone development/management organization in each location. A business-like zone development organization, which puts its own resources at risk and hence is highly committed to project success, almost invariably outperforms less market-driven organizations, even when the latter possess somewhat better sites on "objective grounds." The experience of other countries (including the Dominican Republic and Mexico) indicates that many private firms will pay three times higher rents to be assured the benefits of a responsive management organization, rather than an ineffective or inefficient one. Because the presence or absence of strong management capabilities is an elusive quantity to assess at an early stage of a project, a better approach is to establish designation criteria favoring well-regarded zone development organizations that do most to put their own resources at risk. This approach, as much as any other, can ensure that the inherent economic potential of the free zone sites is fulfilled.

IV. COMPETITIVE ASSESSMENT OF THE URUGUAYAN FREE ZONE PROGRAM

A. BACKGROUND ON URUGUAYAN EXPORT SECTOR INSTITUTIONS AND PROGRAMS

4.01 The fundamental shift in national economic policy that took place in 1974-75 arose from official recognition by government policy-makers that inward-looking industrial development had run its course, and that governmental protectionist policies were one of the main causes of the decade-long economic stagnation.

4.02 The essence of the new economic policy was to promote export-led economic development, through the establishment of highly competitive, private sector ventures, primarily in "non-traditional" export sectors such as the chemical industry, the fishing industry, financial services, tourism, etc. Together with a restructuring of the local financial market and the across-the-board reduction of trade barriers (as mentioned in III.A), the past 15 years have seen the development of an extensive network of promotional instruments -- fiscal, legal, financial, and institutional -- aimed at export-sector development (See Diagrams IV-1 and IV-2).

4.03 The "Foreign Investment Act," enacted in March 1974, represented a clear break with past policies by guaranteeing the repatriation of capital and profits by foreign firms. The act began the process of rebuilding foreign confidence in the financial system.^{/1} Presently, given the Government's established track record concerning free repatriation of capital and profits -- or any other financial asset, for that matter -- protection under this Act is no longer routinely requested by foreign companies.

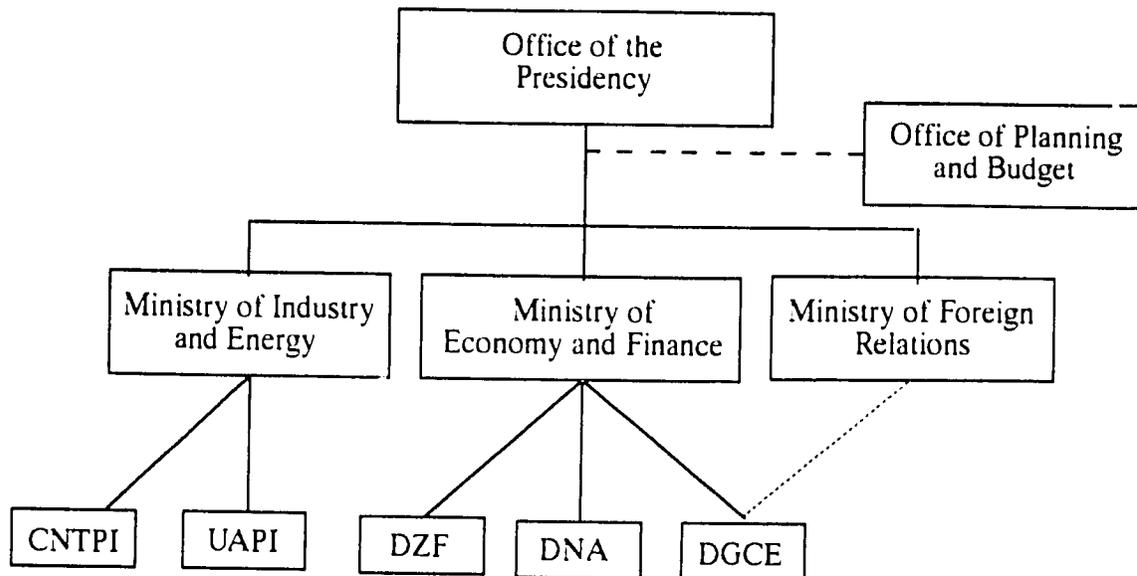
4.04 Of greater use has been the "Industrial Promotion Act," also enacted in 1974, aimed at promoting the activities of national or foreign firms in export-oriented sectors deemed to be of "national interest." This declaration of national interest implies the granting of a certain number of tax exemptions and other incentives, including access to promotional credit lines.

4.05 Two other major export promotion measures have been strengthened since: first, the "Temporary Admissions" and the "Drawback" mechanisms for duty-free entry of primary goods (in existence since 1913, but drastically overhauled in a May 1979 decree), and second, the newly approved Free Zone Law" (1987). Since the tariff rebates under the drawback mode require a case by case authorization by the Finance Ministry, and advance payment of

^{/1} The term "Act" is used to designate this and other legal decisions made by the military dictatorship during the 1973-1985 period. The main body of these decrees have been since ratified as law by the present democratic government's legislature.

DIAGRAM IV-1

**EXECUTIVE BRANCH INSTITUTIONS
AND THEIR FUNCTIONS
IN OVERSEEING URUGUAYAN EXPORT SECTOR REGIMES**



KEY

CNTPI, Centro Nacional de Tecnología y Productividad Industrial (National Center for Industrial Technology and Productivity). This center answers to the Minister of Industry and Energy through the CNPDI (Centro Nacional de Política y Desarrollo Industrial). Its objectives include provision of industrial information and training services, through preparation of technical and economic profiles and studies; diagnosis of industrial sector problems; and general dissemination of information on technology, production, marketing, economic and financial markets. Specific training courses for industrial executives, exporters and managers are provided to the general public.

UAPI, Unidad Asesora de Promoción Industrial (Industrial Promotion Advisory Unit). This organization answers directly to the Minister of Industry and Energy. Its objectives are to promote industrial investment projects, to aid in their preparation and to evaluate their feasibility for the purpose of approving them for government promotion efforts. UAPI has been specifically designated as the advisory body in the "declaration of national interest" procedures, as set forth in the Industrial Promotion Law.

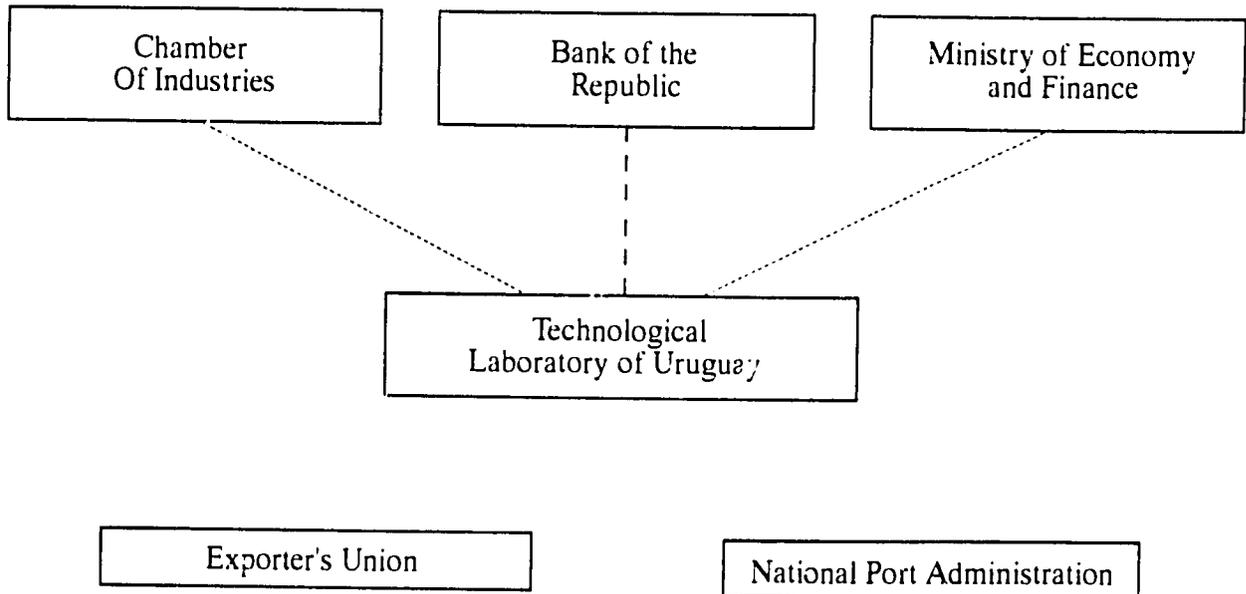
DNZ, Dirección de Zonas Francas (Directorate for Free Zones). The DNZ answers to the Ministry of Economy and Finance. Its objectives are to promote development of free zones for export-oriented industrial, commercial, or services sector activities.

DNA, Dirección Nacional de Aduanas (National Customs Directorate). The Customs Directorate answers to the Ministry of Economy and Finance. Its objectives are standard for Customs administrations world-wide, including verification and control of goods entering and leaving the country, collection of revenues on dutiable items, and suppression of contraband.

DGCE, Dirección General de Comercio Exterior (General Directorate for Foreign Trade). The Directorate answers to the Ministry of Economy and Finance, and coordinates its activities with the Foreign Relations Ministry through the joint designation of its personnel as commercial attaches at Uruguayan embassies. Its objectives include implementation of national commercial policy directives for the development of commerce, the promotion of exports through market studies, international fairs, commercial missions, and identification of demand and supply sources.

DIAGRAM IV-2

**OTHER AGENCIES RELATED TO EXPORT SECTOR PROMOTION
IN URUGUAY**



KEY

Camara de Industrias del Uruguay, the Chamber of Industries of Uruguay is a private association founded in 1898. The objectives include full export and import support services.

Banco de la Republica Oriental del Uruguay (BROU), the Bank of the Republic of Uruguay, was created in 1896 as the official government development bank. Its main objective is to mobilize private savings and orienting them, through specific credit lines, towards the promotion and development of the productive sectors of the economy.

Laboratorio Tecnologico del Uruguay (LATU), the Technological Laboratory of Uruguay, is a public, nongovernmental body whose Board of Directors is composed of three members: one designated by the Ministry of Economy and Finance, another named by the local Chamber of Industries, and the third director named by the BROU. Objectives of LATU include quality control related to import and export procedures, and supervision of firms operating under the temporary admission regime. Other important objectives of the Lab are to provide technical information or know-how (through use of external consultants or training courses) to industrial firms.

Union de Exportadores del Uruguay, the Exporters' Union of Uruguay, is a private organization whose declared objective is the promotion of traditional and non-traditional exports.

Administracion Nacional de Puertos (ANP), the National Port Administration, is an autonomous parastatal organization overseeing all port activities, including loading and unloading of cargo, provision of tug-boat services, etc. It is also the governmental body responsible for licensing maritime service agencies.

import duties, while the temporary admissions mechanism is quasi-automatic and requires no advance payments at all, the former has fallen out of favor with the business community. This chapter, accordingly, analyzes in detail the three most commonly used export promotion measures: the Industrial Promotion Act, the Temporary Admissions import mechanism and the Free Zone Program.

1. Free Zone Program

a. Origin and Development of the Program

4.06 The Uruguayan free zones were created by Law No. 7,953 of June 6, 1923 and designated as the locations contiguous to the ports of Colonia and Nueva Palmira on the western shore of the Republic.

4.07 These zones were intended to attract principally factories and industrial establishments by providing fiscal benefits and Customs exemptions. In actuality, commercial warehousing activities have been installed almost exclusively in the zones, as well as in some cases, firms engaged in the repackaging of merchandise.

4.08 The failure of the zones to attract other industries was largely due to their lack of adequate infrastructure. In addition to the shortcomings in physical facilities and services, the minimal promotional activity, and the robust character of more traditional economic activities, are possible explanations for the less than optimal zone performance.

4.09 Amendments to the free zone regime, enacted in late 1987 and supported by implementing regulations in mid-1988, made the free zone program unquestionably the most attractive of all Uruguayan incentives available to the export sector. The revisions in the free zone law gave lessees in free zones a guarantee that the buildings they paid for and constructed in public zones would not be considered government property, thereby releasing private resources for sorely needed new facilities construction. The law created new freedom for zone-based firms to conduct business in dollars, and created the future option of private management and ownership of free zones. Concurrently, the law addressed the "implicit taxes" of public sector monopolies by authorizing -- for the first time in any free zone statute worldwide -- the demonopolization of public sector services provision within the free zone boundaries.

b. Activity during the past five years.

4.10 The activity developed in the last four years (1985-1988) has been intense, striving to meet the established objectives and to rationally develop the free zone program. Both the Government and private sector have been important forces in the progress that has been realized.

4.11 Commercial activity in the free zones has increased substantially in recent years, as shown in the following table. For example, in 1985, the movement of zone merchandise rose to US\$114 million and by year-end 1988 had reached US\$408 million, an increase of more than 257 percent. In total tonnage, in 1985, a movement of 336,900 tons was registered, for 1988 the level reached 536,968 tons, an increase of 59.4 percent. Other indicators are summarized as follows: trucks servicing the free zones rose from 8,537 in 1985 to 12,780 in 1988; number of containers: 460 in 1986; 1,531 in 1988. Number of persons entering the zones in 1986 -- 24,513 and in 1988, 37,059.

4.12 One of the primary objectives of the present government is the stimulation of new free zone activity, in terms of employment generated and impact on the regional economy. The current total number of jobs in the free zones (restricted almost entirely to warehousing activity) is very difficult to determine, as accurate data is almost impossible to come by, although estimates place direct zone employment at 300 jobs. As new buildings become available for industrial tenants, this figure is certain to be multiplied.

c. Emerging trends in zone activity.

4.13 Despite severe constraints in infrastructure at the existing free zones of Colonia and Nueva Palmira, and a complete absence of available standard factory buildings, more than two dozen companies are reported to have contacted the Direccion de Zona Franca regarding immediate interest in taking occupancy in Uruguayan zones. According to representatives of the Free Zone Users Association, approximately 40 percent of the interested foreign firms are Argentine and 30 percent are Brazilian, attracted principally to Uruguay because of its economic and political stability, liberal incentives, and market access. Increasingly, assembly and fabrication operations are anticipated by foreign investors.

2. Temporary Admissions Program

a. Origin and Development

4.14 Temporary admission is defined in Uruguayan law as "the introduction, free of duty, of specified articles provided that they are re-exported within a defined period after being transformed or manufactured within the country."

4.15 The temporary admission regime has as its principal objective to minimize the costs in terms of export charges and duties that are levied against an export industry which utilizes imported goods (that are not destined for the domestic market) in its production process. Likewise, it is intended to allow for the production using imported goods that are obtained at international prices.

TABLE IV-3

GROWTH OF URUGUAYAN FREE ZONES

	<u>MOVEMENT OF MERCHANDISE</u>					
	<u>US\$ (\$1000's)</u>					
	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988*</u>
INFLOW	60,461	54,183	57,400	78,110	132,482	227,119
OUTFLOW	63,004	58,267	56,500	76,100	117,213	180,989
TOTAL	123,466	112,450	113,900	154,210	249,695	408,109

	<u>MOVEMENT OF MERCHANDISE</u>			
	<u>(metric tons)</u>			
	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988 (6 months)</u>
INFLOW	168,000	160,070	201,445	131,596
OUTFLOW	168,000	130,074	201,445	131,596

	<u>INVESTMENT</u>			
	<u>(US\$)</u>			
	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
PRIVATE	40,000	-	1,500,000	2,840,000
PUBLIC	-	436,650	299,668	666,231

* Annual estimate based on first six months of 1988

4.16 The benefits are granted to those industries that process an imported good, that is to say which utilizes these imports to produce export merchandise and also commercial businesses with regard to the following goods: raw materials, parts, pieces, motors and materials, wrapping and packaging materials, molds, and models.

4.17 In May, 1979, through Decree No. 264/79, the operational regulations of the temporary admission regimen were modified, in an effort to simplify the documentation provide greater flexibility for the export of nationally industrialized products that depend on imported goods under the regimen. These measures were intended to reduce production costs and thereby heighten the competitiveness of the goods vis a vis foreign producers.

4.18 The current temporary admissions program functions essentially as follows: each firm operating under the program is extended a one- year period from the time authorization is received from the Uruguayan Technological Laboratory (LATU) to import, process, and re-export (including transferral to a free zone). Once this period expires, the importer is granted nine months to either import the goods or export them "as is." The operational aspects of the program reflect the flexible and open character of the temporary admission regime with regard to the treatment of imported goods, whenever those products earn foreign exchange.

4.19 Finally, export-oriented firms have the option of using the drawback system, established along with the temporary admissions program in 1913. This system, however, has now practically stopped being used. The difference between the two programs is that with the drawback system duties and charges are paid in advance, and then remitted to the company following re-export. Under the temporary admissions program, on the other hand, its is not necessary to pay the duties in advance. Therefore, the temporary admission mechanism has been much more utilized than drawback which is largely disregarded.

b. Performance Over the Past Five Years

4.20 No recent data are available regarding the number of jobs or export earnings created by firms operating under the temporary admission regime.

3. Industrial Promotion Program

a. Origins and Development of Industrial Promotion Program

4.21 The Industrial Promotion Act (Law No. 14.178) approved on March 28, 1974, set up a special export incentives regime, as an instrument of governmental industrial policy in promoting economic expansion through export growth. The law states that the Executive Office, advised by the Industrial Promotion Advisory

Unit, shall be empowered to declare certain industrial or tourism projects as being of "National Interest", thereby granting them a series of tax and tariff exemptions or reductions and access to promotional credit lines for their investment. All industrial or tourism activities may be declared of "National Interest," thereby benefitting from these special incentive measures foreseen by the Law, as long as the investment projects that seek this approval are in keeping with all, or many, of the following objectives:

- to obtain greater efficiency in production and sales, on the basis of adequate levels of size, technology and quality.
- to increase and diversify the export of industrialized goods that contain the largest possible quantity of added-value to raw materials.
- to set up new industries or expand existing ones, whenever this results in a better and fuller use of existing raw materials and labor.
- to support selected technological investigation programs, oriented toward the economic exploitation of previously unutilized local raw materials, the development of new local-based products, the training of technicians and workers, and the institution of quality-control and certification procedures.
- to increase the relative economic importance of tourism, by upgrading and extending the local tourism infrastructure.
- to develop service activities, excepting financial and insurance services, as long as the Executive Office views these services as an element of support for the development of industry, tourism, or the fishing sector.

4.22 According to the Industrial Promotion Law, the investment projects declared to be of national interest may benefit from fiscal exemptions or reductions and direct credit assistance.

4.23 Fiscal benefits granted under the Law include:

- Exemption from import taxes, consular fees, value-added tax, etc., for the equipment required for the project. (The benefits vary according to whether locally produced equipment of the same type is available.)
- Exemption from real estate and capital taxes, on fixed capital goods that are incorporated in the investment project, for a period of up to three years in Montevideo and five years in the rest of the country. This exemption is presently granted only to the investment projects in the so-called "priority" sectors (see paragraph 3, following page).

- Exemption from income tax for either the firm undertaking the project or its investors, proportional to the total amount of added share capital invested.
- The training expenses of technicians and workers may be taken at twice their total cost in income tax calculations.
- Exemptions of levies required for establishment or modification of the legal entity -- stock corporations, limited liability companies, holding companies -- that will execute the project.
- Reductions on port tariffs, up to 20 percent for capital-goods importation.

4.24 The Industrial Promotion Law also established a series of promotional long-range credit lines to finance projects that are considered to be of national interest. There are presently three main credit lines:

- The Investment for Development Financing Fund (FFID), set up by the Central Bank of Uruguay, to finance investment projects and feasibility studies. The Central Bank has also set up a Guarantee Fund to reduce the mortgage requirements of the banking system, by covering a certain percentage of the capital not paid up and of the accumulated interest payments.
- A credit line from the German Government for small and medium-size industries.
- A promotional credit line of the government development bank, for priority sector enterprises.

4.25 Within the general framework of the I.P. law, the Executive Office established by decree, in 1986, the export sectors that are to be considered to be priority sectors according to the present Administration's industrial policy. The investment projects in these sectors receive, as has been noted, special fiscal consideration. The priority sectors are the following:

- | | |
|---|-----------------------------|
| - meat | - garments |
| - fishing | - leather and leather goods |
| - dairy products | - soaps |
| - flour processing | - glass |
| - malt processing | - earthenware and porcelain |
| - packing and preservation of fruits and vegetables | - construction clay |
| - textiles | - metallic minerals |
| - needlework | - marble and granites |
| - footwear | - semi-precious stones |

4.26 By Decree No. 788/86, the Executive Office declared all

investment activity in the hotel industry to be, generically, of national interest. Thus, all equipment and or construction materials necessary for building or renovating hotels, motels or inns (paradores), are exempted from import taxes, consular fees, value added taxes, and capital or real-estate taxes as stated above. Furthermore, the decree accelerated depreciation mechanisms for all of this equipment and/or material.

4.27 For companies that are planning to upgrade or expand their capacity in a manner that, according to the investment project, will have only a marginal impact on its previous level of activity, the Advisory Unit has set up a special evaluation procedure, which cuts down the median approval delays to about two weeks. To be accepted as a marginal project, however, the investment in equipment cannot be more than 10% of last year's sales, or US\$250,000, whichever is lower.

b. Performance over the past five years

4.28 Investments under the Industrial Promotion Program during the last five years are as follows:

1984	.....	US\$ 14.388 million
1985	.....	US\$ 51.969 million
1986	.....	US\$ 51.752 million
1987	.....	US\$ 53.461 million
1988	.....	US\$ 35.356 million

4.29 Since the Industrial Promotion Program covers all industrial or tourism activities, whether export-oriented or not, the Government has not established regular monitoring systems to measure the contributions of export firms alone operating under the program. Only two recent years have been monitored. In 1981, exports occurring under the Industrial Promotion Program amounted to US\$ 403 million; for 1982, the comparable figure was US\$ 321 million.

4.30 Until 1983, the firms operating under the Program employed jointly 35,701 persons. This total has now fallen to 12,415. The rate of new projects seeking incentives under the Program has also fallen off. According to approved investment project estimates of new job creation, the following are the aggregate figures for the last five years of program activity:

1984	.....	75
1985	.....	712
1986	.....	1,253
1987	.....	1,463
1988	.....	779

c. Emerging Trends

4.31 From an extensive evaluation of the Investment Promotion Program's activities prior to 1984, previous analysts have found that:

Investment trends within the Program have closely followed the shifts in overall private sector investment in the country. Investment conducted through the Industrial Promotion mechanism during the most active years of the Program -- 1980, 1981, 1982 (with an average of US\$90 million per year) -- represented between 7 percent and 12 percent of total private investment in Uruguay. A more precise indicator of the program's contribution can be derived by considering only the total national investment in equipment and machinery, since tributary exemptions are given mainly for these items. In this case, investment by firms operating under the program represented between 14 percent and 27 percent of the total. By percentage of total industry sales (including both local market and export), firms operating under the Program accounted for approximately 20 percent.

Foodstuffs, textiles and chemicals have comprised 73 percent of the total investment. Foodstuffs alone represent 46 percent. According to program officials, this share has remained relatively stable during the last four years.

As of 1983, 42 percent of the firms employed fewer than 50 persons. By contrast, only 9 percent of the firms employed more than 500.

4.32 Although no further systematic evaluations of the Program have been undertaken since 1984, the officials interviewed believe that the total amount of annual new private investment occurring through the program has stabilized, and that the sectoral mix has shifted slightly towards towards the priority sectors defined by this Administration.

B. COMPETITIVENESS OF THE URUGUAYAN FREE ZONE PROGRAM RELATIVE TO OTHER NATIONAL EXPORT REGIMES

1. Benefits package

a. Eligibility criteria

4.34 Both the Free Zone Program and the Industrial Promotion Program require submission of an investment project that is in agreement in its stated objectives with the policy guidelines of the Government in export sector promotion. In this respect, the Industrial Promotion Program can be viewed as the more restrictive of the two, as the main benefits are granted to investment projects within previously defined priority sectors. The Temporary Admission mechanism is, in contrast, more flexible as a quasi-automatic procedure requiring only a previous inspection by LATU of the processing capability of the requesting firm.

b. Approval process

4.35 Temporary Admission exemptions are granted only on an item-by-item basis. Although the most rapid approval process for any specific import is through the Temporary Admission system, the paperwork procedures required by the program compare favorably with the other regimes only if a company plans to import goods on an occasional basis. For firms requiring continuous imports of goods and machinery, the other two programs extend their benefits to all of the subsequent imports of goods by a company. Both the Free Zone and the Investment Promotion programs, however, present a more difficult initial approval process to obtain the blanket approvals.

4.36 Between the Free Zone Program and the Industrial Development Program, approval policies also differ regarding the length of the other benefits allowed. The approval of Free Zone incentives usually implies the granting of full benefits for periods of 25 years or more, while the Industrial Promotion Program generally grants benefits to assembly and manufacturing firms only for the duration of the investment recovery period (including the depreciation and financial repayment periods).

c. Tax provisions

4.37 Under all three of the mechanisms the import taxes and the value-added tax are exempted. This is, however, the full extent of the Temporary Admission exemptions. The Industrial Promotion Program also grants partial and temporary exemption from real estate, capital and income taxes. The Free Zone Program is, in this respect and by far, the one that grants the greatest number of benefits: total and permanent exemption from import taxes and duties -- not granted in the Temporary Admission mode -- income tax, sales tax, real estate and capital tax. In fact, all national taxes "presently existing or created in the future," excepting social security payments, are waived.

d. Tariff relief

4.38 The Industrial Promotion Program may grant a reduction of up to 20 percent on port tariffs, this being the sole tariff relief available under the Program. The Temporary Admission regime grants no tariff relief at all. Again, the Free Zone Program is more extensive in its exemptions. It provides for total exemption from port tariffs, duties and surcharges relative to the entry and exit of capital goods and raw materials.

e. Regulatory relief

4.39 In the cases of the Temporary Admission mechanism and the Industrial Promotion Program, there is no regulatory relief: all import and export procedures must be fulfilled, real estate and capital tax declarations must be submitted for exemption. In utilizing the Investment Promotion Program, moreover, there is

rather an increase of controls and filing procedures related to the granting of benefits. The Free Zone Program, on the other hand, offers regulatory relief by way of abolishing all import and export procedures, and waiver of tax forms or any such controls.

f. Access to private utilities

4.40 Electricity, telecommunications, and petroleum refining, insurance, alcohol production, railroad transportation, among others, are Government monopolies throughout Uruguay. Access to private alternatives is possible only within free zones, and only since the approval of the 1987 Free Zone Law, which specifically invalidated government monopolies within all Uruguayan free zones.

g. Access to debt conversion

4.41 The debt conversion mechanism, administered by the Central Bank of Uruguay -- advised jointly by the Ministry of Economy and the Office of Planning and Budget -- is an independent promotion mechanism set up by the Executive Branch. In theory, any and all investment projects may request the benefit of investing through the debt conversion mechanism. In practice, the total amount of debt that is converted yearly is limited by the Central Bank's authorities -last year's limit was US\$15 million. There is also a time limitation for the presentation of the projects -- this year's presentation period ends in March -- together with a very selective screening process due to the relatively small amount of debt conversion allowed relative to the total yearly investment.

h. Access to local markets

4.42 The only promotional system that allows direct access to local markets with full benefits, is the Industrial Promotion Program. Temporary Admission specifically prohibits local sales, with fines for abusing firms. On the other hand, the Free Zone regime views access of goods from the zones to the local markets as a normal importation procedure, subject to normal import restrictions, tariffs, etc. In fact, one of the main commercial uses of the present public free zones is the warehousing of foreign goods awaiting importation on a partial shipment basis, enabling companies thereby to avoid the advance payment of import taxes and value-added tax on large stocks of goods that may spend months in inventory).

i. Assistance programs

4.43 Neither the Free Zone Program nor the Temporary Admission mechanism includes direct assistance programs in the form of training services, credit lines or other business services. The only one of the three promotional programs considered that includes specific assistance programs within its "menu" of benefits is the Industrial Promotion Program, with the promotional credit lines as detailed above.

4.44 However, the Industrial Promotion Program is not mutually exclusive with the other two programs: any firm operating in the Free Zone areas or locally, under the Temporary Admission mode, may present an investment project with the UAPI, seeking "National Interest" status and, thereby, access to the related promotional credit lines or other facilities. In relation to other business services such as training, insurance service or commercial information, these may be obtained from public or private sources irrespective of whether the firm is local or foreign, operates within the Free Zones or outside them, or has been declared of "National Interest."

2. Identified constraints

a. Free Zone Program

4.45 Users of the existing public Free Zones have identified the following constraints in Free Zone operation:

- Lack of adequate infrastructure in the existing public zones, including roads (especially the access to the zones), communications systems, and general services (maintenance, business promotion, etc.).
- Limitations to access by way of the ports due to insufficient depth of port channels.
- Excessive bureaucratic procedures for the Customs and Free Zone services and controls, including an overlapping of internal administrative proceedings between the Customs Authority and the Free Zone Board.
- Limitations on working hours within the free zones due to the constraints of Customs and public sector work hours and holiday schedules.
- Certain key aspects of the new Free Zone legislation have yet to have fully regulatory implementation, especially concerning the procedures for the certificate of origin, the Value-Added Tax exemptions for free zone services, the guidelines for the new private-zone contracts and others.
- A general lack of resources for the Free Zone Board (Dirección de Zonas Francas), both human and financial. This has led to limitations in infrastructure development, and in provision of direct and indirect services for the existing zones.

4.46 In the view of existing free zone users, even if most of the internal problems of zone management and operations were resolved, the "boundary" problems concerning the movement of people and goods into and out of the free zone would probably remain. These problems include not only specific and inevitable conflicts over

general entry and exit procedures, but the more intractable political pressures arising from bad reputations gained by some local free zone operations as possible conduits for importation irregularities -- i.e. smuggling -- and the ensuing unfair competition for locally established industry.

b. Industrial Promotion Law

Based on an internal evaluation report issued by the UAPI (the Industrial Promotion Advisory Unit) in December 1984, the main criticism of the Program can be made not from the user's viewpoint but from viewpoint of the general interest of the country: the Industrial Promotion Program has a built-in tendency to favor turn-key projects which, systematically, end up with overcapacity problems or technologies ill-fitted to local conditions. From the user's point of view, the system delivers its promise of tax exemptions with adequate efficiency, while the promotional credit lines are not consistently the best available.

3. Conclusions regarding zone competitiveness relative to alternative export regimes

4.47 Viewed strictly as an alternative export regime, it is quite clear that the Free Zone operation offers the more extensive set of tax and tariff exemptions, while granting important opportunities to operate beyond the reach of government monopoly services and yet retain special access to the local certificates of origin essential to preferential trade opportunities within the regional market. The Industrial Promotion regime, on the other hand, has a unique positive attribute from the perspective of some businesses in its access to special credit lines. The Temporary Admission program is, of course, the most limited of the three. However, the three regimes are not mutually exclusive. In fact, the Industrial Promotion incentives are readily available to companies operating under the Free Zone regime -- the Temporary Admission concessions are, in this case, redundant. The Free Zone Law specifically states that, since private free zone developers are not eligible for Free Zone exemptions, they should seek such exemptions -- and possible access to promotional credit lines -- through the Industrial Promotion Program. As for general business services -- technical assistance programs, training programs, information services, etc. -- they are all accessible to any company, whether or not it is operating in a free zone area.

C. COMPETITIVENESS OF URUGUAYAN FREE ZONES RELATIVE TO OTHER ZONES IN THE REGION

4.48 A comparative analysis was undertaken by the project team of the Uruguayan Free Zone regime relative to the incentives offered by alternative zone programs in Latin America and the Caribbean (see Table IV-3). It shows that Uruguay has perhaps the most competitive free zone package, overall, in the region. In terms of the criteria of formal tax relief, Customs exemptions, free

Table IV - 3

COMPARISON OF INCENTIVES FOR EXPORTING FIRMS IN SELECTED LATIN/CARIBBEAN COUNTRIES

	Uruguay (Free Zone)	Barbados (Export Incentives)	Jamaica (EPZ)	Costa Rica (EPZ)	Dominican Republic (EPZ)
Corporate Income Tax Abatement	100 % Exemption in perpetuity	100 % Exemption 10 year holiday	100% exemption in perpetuity	100 % Exemption for 6 years	100% Exemption
Capital/Profits Repatriation	Guaranteed, unrestricted	No Restrictions	No Restrictions	Guaranteed, unrestricted after four years	No Restrictions
Duty Treatment for All Imports and Exports	100 % Exemption	100% Exemption	100% Exemption	100 % Exemption	100% Exemption
No. of Days To Receive Approval	30-60	30-60	30-60	90	60
Tax on Dividends	100 % Exemption unless taxed elsewhere	100% Exemption Nonresidents only	Subject to withholding tax and FX controls	100 % Exemption	100% Exemption in practice
Restrictions on Foreign Ownership	None	None	None	None	None
Sales To Local Market	0% allowed unless full duty paid	0% allowed	0% allowed	49 % of output allowed	20% of output allowed
Training Linkages	None	Yes	Yes	Yes	Yes
Management of Foreign Currency	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted
Eligibility Requirements and Limitations	Zone developers ineligible	100% export only	100% export and foreign companies only	None	None
Electric Power At Preferential Rates	Competitive Services Allowed	No	Cogeneration allowed in EPZs	No	Competitive Services likely
Intern'l Telecommunication Preferences	Competitive Services Allowed; Poss. Teleport	Pending Teleport	Operational Teleport	Pending Teleport	Operational Teleports (2)
Specialized Physical Facilities	Informatics Park Under Consideration	Office Buildings Occupied, Pending	Informatics Park Occupied	Informatics Park Under Development	Informatics Parks Occupied, Under Dev.
Buildings Available For Occupancy	No	Yes	Under Construction	Under Construction	Under Construction
Shelter Plan or Subcontracting Capacity	Potential	Exists	Exists	Planned	Exists

handling of foreign exchange, and especially the demonopolization of public sector commercial services, the Uruguayan incentive regime has few if any rivals.

4.49 Along several other dimensions, however, the Uruguayan free zone program is undistinguished or lacking relative to its competitors. Currently, an investor experiences a somewhat cumbersome process of application review and approval. Although the length of time needed to obtain designation as a free zone company is at par with other free zone programs in the hemisphere, it compares poorly relative to the freeports of the Far East, which operate under an investment registration system. In these programs, companies meeting standard criteria can be eligible to do business in a single afternoon. The majority of the problems with the Uruguayan free zone program appears to rest not with the policies or capabilities of the Uruguayan zone regulatory bodies, but with the severely understaffed and underequipped office of the Direccion de la Zona Franca.

4.50 Uruguay also appears to be less than equal to leading free zones in the hemisphere regarding Customs procedures. As noted earlier, substantial problems have been reported by companies operating the Colonia and Nueva Palmira zones in expeditiously clearing goods through Customs. To be successfully marketed internationally, an EPZ regime must offer timely and efficient customs procedures. By late 1988, however, zone tenants reported that the problems of "border" clearances of free zone goods were being ameliorated, as a result of new Customs policies of single-point inspection.

4.51 The present lack of private sector zone management also puts Uruguayan free zones at a disadvantage. A continuing problem consists of zone user dissatisfaction with the present public sector management of the operational zones. Because of budgetary constraints and inherent public sector procedures, users felt that a hands-on, pro-active management system had yet to be put in place.

4.52 Similarly, substandard infrastructure in the existing zones remains a major competitive disadvantage. The most frustrating problems of users were encountered as a result of the underdeveloped free zone infrastructure, including roads, water, and sewerage systems, although belated budget allocations have led to a recent large-scale effort to remedy the majority of these problems. The pace of new building construction by the public sector has also fallen far behind demand.

4.53 On a related issue, although the recently amended Uruguayan free zone legislation expressly encourages competitive provision of utilities, the existing Uruguayan zones at present fare poorly in comparison with zones of other countries in terms of telecommunications price and service connection delays. Teleports based in Dominican Republic and Jamaican free zones offer dedicated international lines at rates of as little as one fifth

the prevailing Uruguayan prices for equivalent service. Lengthy connection delays for new subscribers are also reported at Colonia and elsewhere.

4.54 In contrast to some countries, the Uruguayan free zone debt-to-equity conversion program has yet to give any priority to free zone-related projects. In Costa Rica, debt-to-equity conversions have been used to finance private free zone development. The Central Bank of Costa Rica and the free zone of Cartago instituted the debt swap conversion, in which the Bank agreed to provide local assets for zone building construction in exchange for retirement of an external debt instrument which Cartago had acquired. The country removed a portion of its external debt while encouraging growth of its export sector; the privately-owned free zone, in turn, benefited from small but significant savings in the local currency component of construction costs, resulting from its purchase of the external debt instrument at a discount in secondary markets. The advantages of free zone debt conversions have attracted strong interest as well in Jamaica and Honduras. The Spanish Fort Free Zone, owned by a private Jamaican developer, has expressed its intent to use Drexel Burnham Lambert Caribe for a debt conversion in a project that is expected to total US\$12 million. In the past year, a Hong Kong zone development group has also approached the Government of Honduras with a request to privatize an existing public sector zone using a debt conversion.

4.55 Finally, the Uruguayan free zone "package" at present lacks sectorally oriented amenities, such as targeted training programs and specialized subcontracting/shelter program capabilities. Rather than rely solely upon direct foreign investment, free zones in such countries as the Dominican Republic and Haiti have helped indigenous entrepreneurs establish operations within zones to meet the needs of foreign firms on a subcontracting or "shelter plan" basis. Foreign companies under these arrangements provide the contract, job specifications, and in some cases the equipment and training needed by the local firm to produce the desired goods. The local subcontractor mobilizes the remaining factors of production and produces the output. Some of the most successful businesses in the Dominican Republic and Haiti have been established by indigenous entrepreneurs who recognized these market needs and responded to them.

4.56 Notwithstanding these constraints, and an almost complete lack of publicity and formal promotion in developed country markets, the free zones now operational in Colonia and Nueva Palmira have a lengthy list of investors requesting space. This already evident demand reflects the recognition of growing numbers of investors -- especially in the warehousing/transshipment sector -- that Uruguay now offers a fundamentally attractive and competitive free zone regime. With removal of the remaining procedural, infrastructural, and related bottlenecks, the rapid growth of Uruguayan free zones appears to be intrinsically feasible.

V. INDICATORS OF FUTURE DEMAND FOR URUGUAYAN FREE ZONES

5.01 To gain a sense of future response to the Uruguayan zone program, TSG and its local associates conducted a preliminary market survey. The survey was not conducted with the range and depth typically given to free zone projects, given that resource constraints limited the project to an opportunity identification, rather than prefeasibility or feasibility, level of analysis. Nonetheless, the preliminary survey confirmed that a substantial demand exists for Uruguayan free zones from both South American and North American firms.

5.02 The project terms of reference called for contacting 35 firms in South America and North America to assess their level of interest in becoming occupants of in Uruguayan free zones. The survey considerably exceeded this number of required contacts with prospective users. A total of 54 firms (42 South American and 12 North American) were sampled regarding their interest in basing their operations within existing or future zones, or in subcontracting business to zone firms. Another 35 firms (22 South American and 13 North American) were contacted as candidates to become development partners in private free zone initiatives.

5.03 Contacts were made by project team members through a combination of telephone interviews and personal meetings over a six month period beginning in December 1989. Although random samplings are often appropriate in a comprehensive prefeasibility or feasibility analysis, the firms surveyed at this stage were not chosen on this basis. Instead, the sample selection was weighted in favor of (1) Uruguayan firms with a known prior interest in or knowledge of Uruguayan free zones, (2) Brazilian and Argentine companies known to be concerned about the stability of continuing operations within their respective countries, (3) North American firms with prior experience in free zone projects in other countries, and (4) North American businesses with the capability to quickly and affordably engage Uruguayan subcontractors in high potential informatics sectors. The selection criteria enabled the project to maximize qualitative market response. Far more comprehensive surveys, however, are needed to prepare absorption rate/lease revenue projections, and these should be undertaken as part of any subsequent prefeasibility or feasibility studies.

5.04 The overall response of the firms contacted in this project far exceeded levels of interest normally encountered in an opportunity identification study. Three North American firms expressed their intent to visit Uruguay in coming months to explore the nature of the free zone opportunities first-hand. Especially favorable responses were round on the part of international telecommunications companies, given the demonopolization of public utilities within Uruguayan free zones. Other North American firms indicated a willingness to negotiate trial subcontracts with qualified Uruguayan informatics firms, or to consider installing operations of their own. The readiness of two telecommunications providers and one prospective zone occupant

to travel to Uruguay constitutes a level of interest rarely found by The Services Group in many previous, more comprehensive market studies for zones in other countries. Among South American firms contacted, abundant interest was also found among both prospective zone users and development partners.

A. SUMMARY OF SOUTH AMERICAN MARKET SURVEY FINDINGS

5.05 A significant level of potential demand for Uruguayan free zones has been revealed from Uruguayan, Brazilian, and Argentine firms and individuals contacted in the market survey undertaken for this project. The survey formally interviewed 42 businesses from the region to assess their interest in installing as zone users. In addition, 22 interviews were conducted with potential zone development partners based in the region. The survey results are summarized below.

1. Responses of Prospective Zone Occupants

5.06 Sectors. The sectoral analysis of the South American survey results shows that firms interested in becoming free zone users were found in a variety of sectors and in different sizes, volume of sales, and operational categories. Specifically, the survey revealed high levels of interest among firms in the commercial, industrial machinery, light industry, and service sectors of the total survey group below:

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Table V-1
SECTORAL BREAKDOWN OF SURVEYED SOUTH AMERICAN
ZONE USER PROSPECTS
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Sector	Number of Firms
Commercial	8
Chemical	5
Industrial Machinery	5
Pharmaceuticals	4
Textiles	3
Communications	2
General Business Services	2
Information Services	2
Metallurgy	1
Industrial Repair	1
Tobacco	1
Toys	1
Paper Pulp	1
Electronics	1
Electrical Products	1
Financial Services	1
Publishing	1
Trading	1
Tannery	1
	<u>42</u>

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5.07 *Geographic Distribution.* Of the businesses interviewed, 14 were of Argentine origin, five were Brazilian, 19 were Uruguayan, and the remaining were European. In general, the firms interviewed had little knowledge of the Uruguayan free zone program, especially those of Brazilian origin.

5.08 *Nature of Business Relationship to Free Zones.* Given that the free zone amendments are recent and there is a present lack of industrial activity in the Uruguayan free zones, almost all of the firms interviewed expressed a desire to become involved on a "trial" basis, i.e. limiting costly equipment and installations. However, most of the businesses interested appeared to be entrepreneurial in structure and willing and able to expand rapidly and undertake more "risky" investments (see Table V-2).

5.09 *Space Requirements.* Among the subset of highly interested South American firms, the average space requirements were 500 sq.m., resulting in a total of almost 10,500 sq. meters of under-roof space. This highly preliminary projection assumes that all of the highly interested parties proceed with free zone projects (and that none of the moderately interested firms does likewise).

5.10 The most important exceptions to this standard were as follows:

Paper industry: Utilization of 300 hectares of land for the factory, industrial park and industrial waste treatment facilities and an additional 70,000 hectares for plantations.

Chemical industry: Of the interested firms, each requires at least 2000 sq.m. under-roof and one an area of 5 hectares.

Tannery: Initially, this type of firm would require room for expansion of 2,000 sq.m. under-roof and a total area of up to 50,000 sq. m.

Metallurgical firm: Operations would need to be initiated with 3,000 sq.m. of under-roof space.

5.11 The facilities requirements of these industries are very specialized and would be likely to require locations apart from regular export processing zones.

5.12 *Specialized Services.* The most often requested forms of specialized services were:

- enhanced telecommunications services, at international prices and standards of service
- financial services adapted to free zone types of operations, especially to expedite payment agreements between Central Banks
- Hotel accommodations suitable for executive personnel.

Table V - 2

SOUTH AMERICAN MARKET SURVEY SUMMARY: POTENTIAL FREE ZONE USERS

Name of Firm	Nationality	Types of Products/ Services	Reason for Interest In Uruguayan Zones	Level of Interest	Comments
Free Trade	Arg./Mex.	Financial Services	Tax Exemptions	High	Represents Am. Banks
World Fabrics	Germany	Textile	General Benefits	High	High Potential
Laboratorios Dispert	Uruguay	Pharmaceuticals	Exploiting Belgian License	High	Will Visit
Compazia Instalada	Argentina	Electric Devices	Free Import of Inputs	High	High Potential
Cassis International	Uruguay	Textile	Open Market for Capital and Goods	High	Interested in Private Zone
SYCOM	Uruguay	Informatics	Trade	High	Radio Shack
La Republicana	Uruguay	Tobacco	Lowest Financial Cost	High	Start-up Bus.
Drilor	Uruguay	Commercial	Expanding Client Base	High	Privatization of Pub. Zone
Ralcos	Uruguay	Commercial	Lowest Cost of Storing Goods	High	Ambitious Ex- pansion Plans
Finantrade	Uruguay	Commercial	Developing Financial Services for Trading	High	Interested in Private Zone
Rogelio Alvarez	Uruguay	Commercial	Tax Exemptions	High	Tradit'l Serv.
Quintalico	Uruguay	Commercial	Exports	High	Trial Venture
Sachi	Uruguay	Telecommunications	Demonopolized Telecom. Facilities	High	Ready to Start

Table V - 2 (continued)

SOUTH AMERICAN MARKET SURVEY SUMMARY: POTENTIAL FREE ZONE USERS

Name of Firm	Nationality	Types of Products/ Services	Reason for Interest In Uruguayan Zones	Level of Interest	Comments
Bilerin	Arg. - Urug.	Services	New Free Zone Services	High	Interested in Private Zone
Exportex	Uruguay	Commercial	Tax Exemptions	High	Interested in Zone near Brazil
Taller Comunicacion	Uruguay	Publishing	Lower Prices of Telecommunications	High	Interested in Private Zone
Adrizil	Brazil	Chemical	Exports	High	Interested in Private Zone
CSPC	Brazil	Informatics	Export Base	High	Highly Specialized
Belcha	Brazil	Trading	Lower Financial Costs	High	Shoe Market
GRAN BS AS RAYDSX	Argentina	Capital Goods	General Exemptions	High	Pending Study
Talleres Grosso	Argentina	Capital Goods	Export Base	High	Wants Meeting
Perkins Argentina	Argentina	Industrial	Access to Brazilian Market	High	Wants Meeting
Area Franca	Argentina	Commercial	Export Base Free Zone Services	High	J.V. Subcontracts
VIM S.A.	Argentina	Toys	Export Base	High	Operates Near Future
Technogel	Argentina	Capital Goods	Export Base	High	Operates Near Future
Lisden S.A.	Uruguay	Chemical	Lowest Cost for Energy	Medium	Pending Study
Roche International	Swiss	Pharmaceuticals	International Trading	Medium	Pending Study
Gaubel	Argentina	Repair Services	Tax Exemptions	Medium	Operating near Future
Ritarco	Uruguay	Commercial	Exemptions	Medium	N/A

Table V - 2 (continued)

SOUTH AMERICAN MARKET SURVEY SUMMARY: POTENTIAL FREE ZONE USERS

Name of Firm	Nationality	Types of Products/ Services	Reason for Interest In Uruguayan Zones	Level of Interest	Comments
RAYCOM	Uruguay	Communications	Export base to Arg.	Medium	Interested in Private Zone
Farmaceutica Uruguay	Argentina	Pharmaceuticals	Export base	Medium	Interested in Private Zone
Curtifrance	Uruguay	Tannery	Better Facilities	Medium	Interested in Private Zone
American Chemical	Uruguay	Chemical	Tax Exemptions	Medium	Interested in Private Zone
Philips	Dutch	Electronics	Export Base	Medium	N/A
Benas S.A.	Uruguay	Metallurgy	Tax Exemptions	Medium	N/A
Pinturas Inca	Argentina	Chemical	Lowest Financial Costs	Medium	Strong Potential
Duperial S.A.I.C.	England	Chemical	Tax Exemptions, Lower Prices of Inputs	Medium	Interested in Private Zone
Nortol	Brazil	Industrial	Exports	Medium	Expects Visit
Bahia Sul	Brazil	Paper Pulp	Industrial Incentives	Medium	Brazil Factory
Rougal	Argentina	Textile	Tax Exemptions	Medium	Pending Study
LNEXPORT	Argentina	Consulting	Trading Services	Medium	Feasibility Study
Gramon	Uruguay	Pharmaceuticals	Exports	Low	Domestic Market Focus

5.13 *Use of Preferential Trade Agreements.* The majority of potential free zone users are interested in producing for regional markets under the agreements of CAUCE, PEC, and to a lesser extent, the agreement with Mexico and under ALADI.

5.14 *Labor.* The Uruguayan labor force was widely perceived as being less subject to labor/management disputes than that of Argentina or Brazil.

5.15 *Perceived Benefits of a Uruguayan Free Zone Location.* The principal benefits perceived included:

- potentially more efficient processing of documents
- open market in terms of free access to foreign exchange guaranteed by law
- tax exoneration
- access to international production inputs without importation restriction
- access to fuel at international prices
- possibility of receiving inputs to export production from their own country of origin.

5.16 *Perceived Constraints to Investment.* The principal constraints identified were as follows:

- excessive bureaucratic and Customs problems
- inadequate access roads to the existing free zones
- lack of deep-water ports and channels for cargo transport
- grave insufficiencies in the supply of industrial parks and auxiliary services
- incertitude regarding the effective functioning and application of the legislation
- concentration of business community in the Montevideo area
- concern over the procedures involved in the entry of subcontracted production to the zones for final processing
- labor code application and labor relations in a concentrated industrial area.

5.17 *Conclusions Regarding User Interest.* In general, a high level of demand among Uruguayan, Brazilian, and Argentine firms was evidenced for the free zone program. The potential for near-term concrete investment appears substantial. Commercial businesses, light assembly activity, capital goods producers, and information services appear to be the highest potential sectors. Locations offering the best quality services and facilities were seen to be the prime locations for new zone development.

5.18 There is substantial interest in Uruguay in using free zones as a means to reduce costs of international production. Brazilian firms evidenced the most demand, relative to the number of firms contacted. From a Brazilian perspective, unrestricted access to foreign exchange, resolution of present difficulties in domestic import procedures, access to international credit, and potential

enhancement of quality of life were cited as being very attractive. Although the majority of Argentine firms were contacted prior to the outbreak of the present extreme economic crisis, they also indicated strong interest in Uruguayan free zone business opportunities.

5.19 The results of this survey indicate that the new free zone space now under construction in Colonia will be quickly occupied and that new zone sites with a broader spectrum and higher quality services and facilities could be very successfully developed in Uruguay.

2. Responses of Prospective Zone Development Partners

5.20 *Property developers.* There are no Uruguayan private developers with prior experience in industrial parks and/or free zone implementation. In Brazil and Argentina, likewise, virtually all industrial parks and free zone facilities to date have been developed by the respective governments.

5.21 Given these considerations, only six private "developers" in Uruguay could be identified and interviewed (Table V-3). Several of these private development groups have experience with the financing and construction of commercial and retail facilities and housing. Three others are currently Uruguayan free zone users, who have arranged for construction of their own buildings in Colonia and/or Nueva Palmira. (Annex D describes the status of two of the most sophisticated, site-specific private free zone development initiatives being considered.)

5.22 Of the private developers mentioned above, five of the six are interested in developing new free zone projects in the Montevideo area. Four developers envisage commercial/industrial free zone facilities. Another group, a leading Montevideo-oriented developer of office properties and shopping centers, has shown particular interest in a services and informatics-oriented free zone with a teleport component. The remaining group is interested in developing a free zone in conjunction with a deep-water port.

5.23 The private development groups expressed varying levels of interest in co-development partnerships with foreign firms. One prospective zone developer with extensive construction experience expressed confidence in having the technical capability to construct a free zone without outside assistance, with the exception of the design input for the specific needs of high-technology sectors. Others indicated a willingness to consider financial and marketing relationships with overseas developers.

5.24 *Other potential zone development consortia participants.* Beyond traditional property developers, free zone development partnerships often include roles for firms specialized in financing, constructing, and managing facilities, in the provision

Table V - 3

SOUTH AMERICAN MARKET SURVEY SUMMARY: POTENTIAL FREE ZONE DEVELOPMENT PARTNERS

Name of Firm	Nationality	Type of Products/Services	Reason for Interest In Uruguayan Zones	Level of Interest	Comments
<i>Property Developers</i> Estudio Luis Lecueder	Uruguay	Commercial properties	Possible new market	High	Montevideo site identified
Dovat y Carriquiri	Uruguay	Eng., Construction	High-potential market	High	Has option on Montevideo site
Sachi S en C	Uruguay	Investment Promoter	New investment project	High	Montevideo site
Estudio Cr. Nieto	Uruguay	Construction	Free zone services modernization	High	Montevideo site
Norte Ltda.	Uruguay	Construction	Industrial property market	High	Punta del Este
TechInt (CTI)	Uruguay	Construction, Industry	Possible Markets	High	Pending reply
<i>Financial Institutions</i> Citibank	U.S.	Lending	Debt swap	Medium	Cntry Exposure
Bank of Boston	U.S.	Lending	Debt swap	Medium	Cntry Exposure
<i>Communications Firms</i> Isbel	Uruguay	Telecommunications	Demonopolized telecommunications	High	TV Programng
Impsat	Argentina	Telecommunications	Demonopolized telecommunications	High	Under study
<i>Technical Specialists</i> SACEEM	Uruguay	Infrastructure Constr.	Possible market	Medium	Only constructn
Estudio V	Uruguay	Construction	Architectural design	High	Only design
CIIDU	Uruguay	Consulting	Meeting market needs for Brazil trade	Med.-High	Rocha/Castillos priority
Arq. Usera	Brazil	Architectural design	Possible market	High	Brazilian link
Prof. Silvio dos Santos	Brazil	Technical specialist	Technology transfer	High	Univ. affiltns
Ciapessoni y Falco	Uruguay	Construction	Possible market	High	
Alv. Pais Quilhilirry	Uruguay	Waste recycling	Recycling services	Medium	
Esc. Hugo Portas	Uruguay	Project manager	Consulting services	Medium	
Lonesud	Brazil	Consultant	Biotechnology	High	Rocha-based
Jopse Papantonakis	Uruguay	N/A	New free zones services	Medium	Montevideo site
<i>Training/Research Inst.</i> Consejo Nacional de Desarrollo Cientifico	Brazil	Technology	Technology transfer	Medium	Public sector oriented
Fund. Parqu de Alta Tecnologica S. Carlos	Uruguay	Tech. Start-ups	Technological joint ventures	High	New materials

of necessary utilities and support services, and in the maintenance of links with business-oriented training and technical institutions. Overall, the interviews with South American zone development consortia candidates covered the following range of firms:

- 7 construction contractors with industrial development experience
- 2 international banks
- 2 telecommunications firms
- 3 business consulting groups
- 1 investment promotion firm
- 1 architectural firm
- 1 technical services firm specializing in waste management
- 1 university-based project development group
- 1 project management group
- 1 state technology development agency
- 1 technology foundation
- 1 socio-economic development group.

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5.25 The international banks contacted are specifically interested in providing support for the expansion of free zone-based operations. One expressed willingness to provide assistance in zone development.

5.26 With regard to basic infrastructure within the free zones, considerable interest was expressed by firms now providing a variety of services in Uruguay. One of the telecommunications firms, based in Argentina, stated that it could facilitate an interconnection between the two countries. Another is interested in installing a satellite earth station in an Uruguayan free zone. Likewise, the company with expertise in the installation of waste treatment facilities indicated that it could service a community of industrial users at lower cost than is presently available through the public sector.

5.27 Virtually all of the various business support services contacted -- design firms, business consultancies, etc., -- were interested in providing their services to firms established in the new zone projects. In other countries, such contributions have been recognized with equity compensation in lieu of fees by private zone developers. From a technical standpoint, several skills development, research, and technology institutions revealed their interest in working in areas such as training of zone workers, and creation of linkages with the local business community, international joint ventures.

B. SUMMARY OF NORTH AMERICAN SURVEY FINDINGS

5.28 The survey of North American firms also confirmed unexpected levels of interest in business opportunities related to Uruguayan zones. The survey contacted 12 businesses from the region to assess their interest in installing as zone users. In addition, 13

interviews were conducted with potential zone development consortium partners and services providers based in the United States and Canada. The survey results are summarized below.

1. Responses of Prospective Zone Occupants

5.29 *Sectors.* As shown in Table V-4, the sectors targeted in the North American survey were concentrated in the informatics export sector, for several reasons. First, the most distinctive advantage of the Uruguayan free zone program relative to its established competitors consists of the provision for demonopolized communications services under the free zone act. Uruguay accordingly has an unusually strong position to compete effectively for business in these rapidly growing market segments. Second, the decision to emphasize informatics allowed the surveyed firms to largely ignore the problems of high freight costs; telecommunications-intensive informatics operations render distance largely meaningless, given the distance insensitivity of satellite communications. (By contrast, most assembly/manufacturing operations oriented toward the U.S. or European markets would be discouraged by Uruguay's relatively high freight costs.) Third, the impact of Uruguay's labor costs -- which are higher than found in a number of competitive countries -- is minimized by targeting sectors dependent upon high standards of knowledge and skill. Information industry operations meet this objective well. Fourth, the nature of many (but not all) informatics services makes them predisposed to fast-start investments and to low-cost startup of subcontracting relationships.

5.30 One exception was made to the general policy of targeting informatics industries in the survey of potential North American zone user firms. Although many North American firms have been reducing their presence in Latin America, the project team encountered one firm -- Ansell, a large latex rubber products manufacturing and distribution company -- with a high degree of interest in penetrating the Brazilian market. In the case of this firm, the regional market orientation could minimize the consequences of otherwise high international freight costs in Uruguay.

5.31 As indicated in Table V-5, the North American market survey found that Uruguay holds a strong position as a result of its factor costs for export of a variety of mid- and up-market information processing services. Nonetheless, concerns over language differences, potential difficulties in quality and copyright control, and nonstandardized job procedures remain high.

5.32 *Geographic Distribution.* All of the firms contacted during the market survey were based in the United States. The manufacturer/distributor of latex rubber products, however, was a U.S.-based company of principally Australian ownership.

5.33 *Nature of Business Relationship to Free Zones.* As with the South American firms contacted, virtually all of the investors interviewed expressed a desire to become involved on a "trial" basis, i.e. limiting costly equipment and installations. However,

Table V-4

SECTORAL BREAKDOWN OF SURVEYED NORTH AMERICAN
ZONE USER PROSPECTS

Sector	Number of Firms
<i>Information Services</i>	
Interactive Courseware	1
Software Development	2
Computer Graphic Design/Technical Art	3
Data Entry/Secretarial Services	3
Animation, Video Programming	1
Translation Services	1
<i>Commercial/Industrial Operations</i>	
Rubber products distribution	<u>1</u>
	12

one start-up data entry firm appeared willing to undertake a direct investment. This group -- which had narrowed its search to the Dominican Republic, Barbados, and St. Lucia -- has decided to extend its field investigations to include Uruguay, after hearing of the demonopolization of international telecommunications. The group intends to specialize in fast-turnaround data entry operations for clients in the New England area, utilizing Group IV facsimile equipment to transfer source documents offshore. The higher labor costs of Uruguay relative to some, but not all, of the alternative sites being assessed (Barbados has comparable hourly rates) will weigh less in the final decision of this firm than the affordability of international telecommunications services. The venture intends to start with a small (10 workstation) operation, growing to 40 or more within the first year.

5.34 In the industrial/commercial category, the latex rubber products company also indicated that it would be interested in a direct investment (via a joint venture with a local partner) rather than a subcontracting relationship. Initially, it would establish a warehousing/repacking operation to service the Brazilian market. Later, if the quality of South American latex provide adequate, local inputs would be introduced into the production process.

5.35 Subcontracting and purchasing relationships proved attractive to several of the informatics companies contacted. Two North American firms specializing in software-related services indicated a significant interest in assessing the capabilities of Uruguayan programmers and computer graphics specialists on a test basis. A leading distributor of software for the Macintosh computer, Heizer Software, indicated a special interest in reviewing the work of Uruguayan programmers who have Hypercard programming capabilities.

Table V - 5

NORTH AMERICAN MARKET SURVEY SUMMARY: POTENTIAL FREE ZONE USERS

Name of Firm	Nationality	Type of Products/Services	Reason for Interest In Uruguayan Zones	Level of Interest	Comments
<i>Information Services</i>					
R. Smillie	U.S.	Data Entry	Fast-turnaround via Group IV fax	High	Will visit
Authorware	U.S.	Interactive Courseware	Interactive courseware prep. savings	High	Probable test
Heizer Software	U.S.	Software Distributor	Free lance programmers (royalties)	High	Seeks links
Kelly Girl	U.S.	Secretarial Services	Fast-turnaround capacity	Medium	More info req.
Macromind	U.S.	Animation, Video	Contract animation labor savings	Med.-Low	Pending
TechArt	U.S.	Technical Manuals	Translation cost savings	Low	Quality control worry
Design Access	U.S.	Graphic Design, Art	Labor savings for custom projects	Low	Design, not volume prodctn
Manpower	U.S.	Secretarial Services	Labor savings	Low	Not a serv. bur.
Globalink	U.S.	Translation Services	Editing of machine translations	Low	Unlikely test
Media Clip Art	U.S.	Commercial Art	Affordable free lance artists	Low	Legal risk
Hypermedia Solutions	U.S.	Hypertext Software	Affordable programmers	--	Pending
<i>Commercial/Industrial Operations</i>					
ANSELL	U.S./Aust.	Latex Rubber Products	Access to Brazilian Market	Medium	May visit

Heizer distributes more than one million catalogs of its products annually, and shares royalties equal to 50 percent of the software sales price with its international network of programmers.

5.36 A Minneapolis firm which produces computer-based learning programs also is interested in Uruguayan programmers as possible subcontractors. This company, Authorware, is a leader in the creation of graphics-intensive courseware authoring tools, and has recently established a library of reusable courseware modules. An internal document of guidelines for affiliated courseware programmers is now being prepared, as well as a computer-based tutorial on programming in Authorware's object-oriented programming language. Authorware is interested in discussing subcontracting relationships with qualified Uruguayan firms, for such operations as coding of courseware from prototypes provided by Authorware, as well as undertaking possible English-Spanish translations and graphic effects.

5.37 *Space Requirements.* With two exceptions, the North American prospective users contacted in the survey indicated that they would only consider subcontracting relationships. The two prospective direct investors (R. Smillie and Ansell) would initially require less than 1000 sq.m. of office space and 2000 sq.m. of industrial/warehousing space respectively. Because the amount of demand for subcontracting of informatics services will be determined by the outcome of the trial projects, the survey was unable to quantify the full scope of space requirements that could materialize from business relationships with the firms contacted in the sample.

5.38 *Specialized Services.* The most often requested form of specialized services were low-cost international telecommunications capable of clear channel (single satellite hop) links to the United States. For the data entry venture, the demonopolization of free zone-based international communications was the sole reason for its decision to include Uruguay on its list of semifinalist countries. In addition to improved telecommunications links, several companies expressed a strong desire to see educational/training initiatives in Uruguay oriented toward computer-based graphic design, and hypertext and object-oriented programming skills. Free zone-related training programs, in their view, should also emphasize practical rather than theoretical training, with inputs in curriculum design and equipment choice from export-oriented firms.

5.39 *Use of Preferential Trade Agreements.* The producer/distributor of latex rubber products was the only firm interested in preferential trade agreements, in view of its orientation towards the Brazilian market. The information services companies contacted felt there would be no tariff or non-tariff trade barriers limiting access to target markets in North America.

5.40 *Labor.* None of the companies contacted had formed any distinct prior impressions of the Uruguayan labor force. Most said that bilingual Spanish/English upper-level workers would be essential.

5.41 *Perceived Benefits of a Uruguayan Free Zone Location.* The primary attraction of a business relationship with Uruguayan free zones for most firms was the significant labor cost advantage, and the ability (with installation of a free zone-based teleport) to send time-sensitive materials affordably to the lower cost workforce. In the case of the industrial/commercial enterprise contacted, the primary attraction of Uruguayan free zones was the stability of the country relative to its neighbors, the lack of controls over foreign exchange, and the presence of preferential trade agreements with Brazil.

5.42 *Perceived Constraints to Investment.* The principal constraints identified were as follows:

- the absence of established subcontracting firms with specialized capabilities;
- the lack of existing low-cost international telecommunications facilities;
- the distance of Uruguay from the United States (cited by the data entry company as a barrier to travel by U.S. trainers and quality controls managers during the startup of Uruguayan operations);
- difficulties with doing business in a Spanish language environment;
- legal risks, given the vulnerability of U.S.-based firms to lawsuits if pirated works were presented as original by the offshore service bureaus (cited by a U.S. computer graphics firm, based in New Jersey, which cooled after an initially favorable response to engaging offshore producers of "clip art" libraries of specialized illustrations); and
- difficulties in ensuring uniform job execution procedures, allowing U.S.-based quality control teams to efficiently modify work generated offshore.

5.43 *Conclusions.* The sampling of North America-based prospective zone users was split sharply between firms with high and low degrees of interest in the Uruguayan free zone opportunity. The Uruguayan free zone legislation's openness to competitive, private sector provision of international telecommunications services is unquestionably seen as the most unique and powerful reason for doing business in the country. Firms interested in subcontracting relationships, rather than direct investments, proved a large majority of the sample. On the other hand, substantial barriers remain in the view of many firms to the development of business relationships in Uruguayan zones. Several firms initially attracted to the possible labor cost savings felt decisive steps must be taken to enforce copyright protection, to reorient skills training initiatives, and to create structured job execution methodologies for offshore service bureaus that are compatible with those applied in the United States.

2. Responses of Prospective Zone Development Partners

5.44 The market survey generated a strong response on the part of North American firms as participants in potential private free zone development partnerships with Uruguayan counterparts. As shown in Table V-6, the survey concentrated upon property developers and telecommunications firms, and identified a particularly high level of interest among the latter group.

5.45 *Property developers/investors.* In response to the market survey, a Canadian engineering firm/developer stated its willingness to mobilize financing for construction of factory buildings in Colonia or in a new free zone project near Montevideo. The investment interest of the Canadian firm, which has financed and built industrial properties in Mexico's duty-free "maquila" sector, would be conditioned on securing valid lease contracts with incoming zone tenants. This should not present an obstacle given that more than two dozen firms from Argentina, Brazil, and Uruguay have approached the Government with requests for free zone space, but have been unable to be accommodated because of a lack of infrastructure and available buildings in Colonia. Another prospective source of capital, a company that owns the ninth largest steel producer in the United States, has expressed interest in participating as an investor in either a free zone real estate development project or in associated infrastructure. A principal of this firm, David Cannon, has to date concentrated efforts on free zone development initiatives in Mexico, but is considering a trip to Uruguay in light of the country's recent reforms in zone legislation.

5.46 *Other potential zone development consortia participants.* Other types of North American firms also expressed high levels of interest in the Uruguayan free zone opportunity. A leading developer of teleports in Latin America, responsible for establishing the pioneering San Isidro (Dominican Republic) Free Zone's satellite links with the U.S., has confirmed by letter its intention to schedule meetings with Uruguayan public and private decisionmakers regarding prospects for an informatics-oriented free zone. The cost of teleport earth stations is as low as \$75,000, with an installation and testing lead time of four months. Representatives of Alpha Lyracom said they will be particularly interested in exploring with the Government the issuance of "landing rights" approval for international business communications services to Uruguayan free zones via the Pan American Satellite system, and the technical coordination of new service with INTELSAT, the international satellite organization of which Uruguay is a member.

5.47 Another leading free zone/teleport developer (a subsidiary of GTE) has also indicated its readiness to send a mission to Uruguay in coming months, to explore prospects for a teleport in one or more Uruguayan zones. In the Dominican Republic, this company has invested several million dollars in two successful private free

Table V - 6

NORTH AMERICAN MARKET SURVEY SUMMARY: POTENTIAL FREE ZONE DEVELOPMENT PARTNERS

Name of Firm	Nationality	Type of Products/Services	Reason for Interest In Uruguayan Zones	Level of Interest	Comments
<i>Park Developers</i>					
Can. Adv. Engineering	Canada	Maquila-style plants	Unmet building needs	High	Can raise \$ on valid leases
Cannon Industries	U.S.	Heavy industry	Investments in property or utilities	Medium	Possible travel
L.C. Holdings	U.S.	Land Development	Infrastructure improvements	Medium	Wants meeting
Bechtel Civil	U.S.	Free Zones (B-O-T)	Possible market	Low	Turkish Zone B-O-T failed
McMillan Development	U.S.	Commercial, residential	Possible market	Low	U.S. focus
Carolina Trade Zones	U.S.	Trade Zones, ind. parks	Possible market	--	Pending reply
William Grant	U.S.	Industrial properties	Possible market	--	Pending reply
<i>Communications Firms</i>					
Alpha Lyracom	U.S.	Teleport Services	Demonopolized Market	High	Will visit
GTE/Codetel	U.S./D.R.	Teleport Services, CAD	Demonopolized Market	High	Planning visit
Unicom	U.S.	Teleport Developer	Demonopolized Market	Medium	May visit
Comsat	U.S.	Teleport Developer	Demonopolized Market	Medium	May visit
NYNEX	U.S.	Telephone Services	Demonopolized Market	Low-Med.	Tech. Incompat.
AT&T	U.S.	Teleport Developer	Demonopolized Market	--	Pending reply

zones, and has established a teleport ("Infoport") providing dedicated communications links for data entry and computer graphics companies exporting to the U.S. market. GTE has recently developed a low cost, INTELSAT-compatible earth station (for approximately US\$150,000) which can be installed rapidly at free zone locations and which avoids the necessity of technical coordination with INTELSAT under "separate satellite" provisions. Two other developers of teleport facilities, COMSAT (the U.S. signatory to INTELSAT) and Unicom (developer of the Denver teleport) have also expressed (qualified) interest in the Uruguayan free zone opportunity. COMSAT's participation would be conditional on finding arrangements congenial to its Uruguayan counterpart, ANTEL. Unicom indicated its readiness to join with Pan American Satellite as an investor in an Uruguayan teleport, subject to Government authorizations of landing rights and agreement to undertake INTELSAT coordination.

5.48 *Conclusions.* In summary, despite an extremely limited sampling, North American developers, investors, and especially telecommunications service providers, clearly evidenced a positive market response to Uruguayan zone development opportunities.

VI. STRATEGIC DECISIONS TO PROMOTE EFFECTIVE MARKETING OF URUGUAYAN ZONES

A. OVERVIEW OF ZONE PROMOTION EXPERIENCES IN OTHER COUNTRIES

6.01 As with other economic development initiative which relies heavily on private sector participation, strong marketing and promotion can be critical to the success of free zone programs. Host country governments and individual free zone developers often neglect to implement such marketing and promotion efforts in a cost effective and sustained manner.

6.02 One end of the spectrum is to be completely passive, in keeping with the assumption that a product will sell itself if it is sufficiently attractive. Such a strategy, except in extraordinary circumstances, yields results slowly, as it relies on endorsements from (satisfied) tenants. Even if this approach is adopted--as was fundamentally the case with Malaysia's free zones and the several Taiwanese free zones -- zones may eventually become fully leased out. The strategy is risky, however, for countries without a widespread positive reputation among foreign investors.

6.03 Somewhat more active promotional strategies have been undertaken by individual free zone developers, either alone or in tandem with government-sponsored national investment promotion campaigns. The privately-owned and operated free zones of Costa Rica and the Dominican Republic have placed zone-specific advertising in trade publications, and engaged foreign representatives under commission-based and limited retainer arrangements, with excellent results. In both cases, aggressive national investment promotion efforts undertaken by private sector organizations (CINDE of Costa Rica and the Investment Promotion Council of the Dominican Republic respectively) have also generated many referral leads for free zones in their country, through sectorally targeted advertising, telemarketing, industry show participation, generation of free publicity, direct mail, and personal meetings.

6.04 Finally, some zones have wasted millions on promotional campaigns that attempt to interest companies in free zone programs encumbered with crippling flaws. The fundamental concern of foreign investors is the ease of establishing a business in a zone, and, subsequently, the cost and quality of both production in and shipments to and from the zone relative to their international competitors. Zones with severe constraints in these regards -- such as the Dubai Export Processing Zone (in the Middle East) and the Darwin (Australia) Trade Development Zone -- have invested enormous funds in international advertising and in direct promotion, with minimal foreign investor response.

training of staff in dealing with foreign investors, and the implementation of effective prospect tracking and follow-up systems are key elements in institution-building.

3. Selecting Cost-Effective Methods To Reach Potential Users

6.09 Successful free zone promotion programs also rely upon the use of cost-effective media for promotion, including a recognition of the key roles of (positive) free publicity in international business media and especially of endorsements/referrals from satisfied free zone tenants. After selecting a distinctive zone promotional theme, a variety of promotional media -- including advertising, direct mail, telemarketing, creation of news events, and industry show participation--are assessed by zone promoters from the standpoint of time and budget constraints. Modular, professional presentation materials are prepared and kept regularly updated. Finally, when beginning a new promotion campaign, successful free zone promoters will gain valuable experience by initially targeting the smaller and less well-known companies in the desired sectors, before making contacts with leading firms.

C. IMPLICATIONS OF PROJECT ANALYSIS FOR URUGUAYAN ZONE PROMOTION STRATEGY

6.10 As applied to the Uruguayan free zone program, the following strategic decisions accordingly stand to maximize private sector response.

1. Creating a Marketable and Distinctive Free Zone "Product"

6.11 Immediate decisions are recommended concerning the improvement of the existing Uruguayan free zone program. Specifically, decisions by Government should be made toward the following ends:

6.12 *Increasing the simplicity of the investment approval process.* A decision should be made regarding the free zone program in Uruguay to create the maximum in simplicity: A Singapore or Hong Kong-style investment registration system, in which a prospective free zone user can complete the paperwork to register the company and obtain legal status to begin operations in a single morning or afternoon. (The simplicity of obtaining approvals to begin operations, coupled with their minimal tax, tariff, and regulatory operating constraints, has given the freeports of Singapore and Hong Kong an invaluable business reputation.) The operative assumption toward investors sent by such a policy is one of "innocent unless proven otherwise" -- a reassuring message to private firms that may be entering an unfamiliar regional or national operating environment. Under a registration system, however, it is essential that all investors understand the penalties for fraudulent or misrepresentative statements regarding their background and operations, for failure to abide by the

public health and safety laws of the country, or for other breaches of law or contract.

6.13 Alternatively, if an investment registration system is considered too ambitious, a true "one stop" investment application approval center should be created with a legislative mandate to automatically grant investor approvals to firms meeting simple qualifying criteria. The Government might adopt policies stipulating automatic approval of an investor application within a defined period (under some pending free zone codes, such period will be 15 days), unless action to the contrary was taken by the Government to disapprove the project. A one-stop center should also consolidate all of the associated permits necessary for doing business in one physical location, enabling the applicant to procure water, power, sanitation, and health, and labor-related forms without delay for priority processing. In Costa Rica, a physical center--housing multiple ministries--has been created in lieu of consolidating all approval powers within a single administrative body. Investors seeking application approvals can thereby obtain them in 45 minutes or less.

6.14 Under either the investor registration or the application review approach, the Government of Uruguay should hold investors strictly accountable for the veracity of the background information provided, including the credit ratings and police records of principals of the applicant firms on the registration form and on subsequent annual filings. Mauritius, among other countries, imposes severe penalties upon companies found to have made false or misleading statements.

6.15 *Privatizing the existing public sector zones.* Many concerns were expressed by private industry over the public sector management of the Colonia and Nueva Palmira zones. Without a doubt, the preparation of new available industrial lots in Colonia constitutes progress toward facilitating the expansion of its operations. However, the present infrastructure endowment is inadequate for certain types of industrial investment, such as high-energy consumers, firms requiring broad potential expansion areas, or those requiring the services of central sewage treatment facilities. The development of adequate infrastructure will be a key element in the attraction of new investment. To resolve the present deterrents to business expansion within the zones, the Ministry is strongly urged to make a policy decision in the near term to transfer all further development and management responsibilities to private parties. Similarly, to the extent the time or resource constraints prevent the government's current infrastructure improvement efforts from resolving these problems, the Government could clearly state its readiness to entertain private sector initiatives in these areas, and indicate the availability of special incentives (such as non-inflationary debt/equity conversions, as discussed below) to mobilize the needed capital. The development through private initiative of the existing free zones can provide needed physical improvements at no cost to the State. Potentially, private management of the zones

could raise the quality and operational standards, and stimulate the users to cooperate in the maintenance and improvement of the zones. Under this alternative, the State could concentrate its efforts in supervision to guarantee the compliance by zone operators and users with overall laws and regulations.

6.16 *Creating guidelines for designation of additional private zones for new technology-intensive sectors.* With equal priority, it is recommended that the Government announce its intention to designate new private zones in the Montevideo region, oriented toward technology-intensive sectors. The competitive analysis and the market survey indicates that a promising opportunity exists for one or more such private zones, targeting knowledge-intensive industrial and informatics-oriented operations. The New Technology Zone (or zones) would be open to firms in all sectors, but their training programs and other initiatives would comprise a distinctive package for the targeted sectors.

6.17 To stimulate private sector initiatives in response to these "upmarket" zone development opportunities, the Ministry of Economy and Finance is urged to issue clear designation guidelines for private developers regarding the creation of New Technology Zones. These criteria should give primary weight to two factors (1) the amount of risk capital or other private resources committed to the project and (2) the inclusion of special amenities oriented to technically advanced sectors. Special emphasis in this respect should be given to the developers' plans for "business incubator" facilities in the proposed zones, to maximize the participation of Uruguayan entrepreneurs in the success of the new projects. The business incubators -- centers designed to support indigenous startup enterprises -- can accelerate leaseout of the zone real estate, while contributing to penetration of world markets by the Uruguayan entrepreneurial community. As successfully established in other countries, incubators may provide a broad spectrum of ad-hoc services (such as project studies, insurance, representation, financial management, secretarial services, local area telecommunications networks, data processing, property management, maintenance, and security services).

6.18 To ensure the most rapid possible success of the New Technology Zones, the Government could permit the new private zone developers to offer temporary free zone space in existing industrial and/or office properties, subject to agreement on transferring the incoming tenants to the new site within a specified period.

6.19 *Establishing new financing options for zone development.* Several options exist by which the Uruguayan government can induce the private sector to more readily mobilize the needed zone development resources. In the case of privatizing the public sector zones, the Ministry of Economy and Finance might work with an Uruguayan development financing institution to undertake a pilot project for "securitization" of the present value of anticipated lease revenues. To augment financial resources for

zone expansion, the institution could issue the equivalent of mortgage bonds for specific zones (or for individual buildings within zones), backed by pledged lease revenues. The amount of money that can be mobilized by this means will depend upon the net income (above any other debt service and operating costs) which is available to fund the payment stream for the bond issue, including payments into a sinking fund or some other form of amortization. Free zones are excellent candidates for such mortgage bond issues, because the revenue stream backing the bonds could be based in freely repatriable dollars and is derived from contractual lease agreements.

6.20 To further stimulate private investor interest in zone development, possible changes in the Uruguayan debt conversion program could also be useful. The Government has thus far refrained from giving private free zones consideration in its program. This stands in contrast to several regional competitors, including Costa Rica and Jamaica. In Costa Rica, the Government authorized a debt conversion for the rapidly-growing Cartago Free Zone. The Jamaican Government has recently declared that free zones will be among the top three priority sectors for debt conversions, as a means of meeting substantial backlogs in the supply of zone buildings. (The government of the Dominican Republic has also expressed its intention to give priority to free zones in its pending debt swap program.) The Central Bank of Uruguay may wish to consider establishing especially liberal policies for debt swap financing of free zone development. In contrast to other possible applications, debt conversions for free zone development are particularly attractive for a country because zone firms are labor intensive and export-oriented. Unlike debt conversions that generate only portfolio investment, debt swaps for free zone development can mobilize incremental direct inflows of capital by attracting new export-oriented firms to a country. The balance of payments of sponsoring nations is positively affected by the free zone development as zone occupants convert foreign exchange for payments to labor, utilities, and other host country factor inputs. Inflationary impacts can also be completely offset by offering sale or leasehold interests in free zone-designated land to the foreign investor, in lieu of issuing local currency.

6.21 A policy of encouraging free zone debt swaps also enables a country to permit unrestricted repatriation of profits and dividends on the part of private developers. At present, countries often impose limits upon the pace of hard currency repatriations in debt swap-financed projects, out of a desire to avoid worsening their near-term net foreign exchange outflows. Private investors underwriting free zone development projects, however, need not be placed under such constraints because their zone lease revenues do not need to enter into the jurisdiction of the Central Bank. Accordingly, movements by a developer of hard currency earnings out of a zone do not adversely affect the country's balance of payments. The result of this unusual attribute of free zones can make debt swaps for zone construction far more attractive to

investors than debt swaps for other types of projects subject to normal repatriation constraints. Moreover, the inherently favorable tax and tariff climate of free zones can make other debt conversion projects -- including infrastructure privatization-- more feasible within zones than outside.

6.22 *Authorizing private sector international telecommunications links.* Telecommunications service prices are a critical area for improvement. Although quality of local and international service is generally good, the prices charged by ANTEL are far higher than now found in free zones elsewhere in Latin America. Recent sharp declines in satellite earth station costs (a 3.6-meter teleport is now on the market for less than US\$75,000) make it unquestionably feasible for private developers to install teleports in free Uruguayan zones. The Government of Uruguay should explicitly indicate its readiness to give priority approval to such initiatives within the zone boundaries. In this line, the Government should examine the experiences of other Latin American countries with "separate satellite" systems, and adopt a policy of coordinating with INTELSAT the use of the Pan American Satellite or other alternative systems. Negotiations with authorities in neighboring countries regarding telecommunications service liberalization could similarly promote the movement of a wide range of regional informatics operations into Uruguayan zones. Privately financed microwave links between Uruguayan zones and Argentina could expedite the flow of industrial, commercial, and informatics operations to Uruguay. Similarly, arrangements under INTELSAT "transborder" service policies could be made to lease dedicated lines on Brazilian domestic satellites, to increase the attraction for Brazilian firms of establishing business operations in Uruguayan zones.

6.23 *Encouraging development of zone-affiliated subcontracting capabilities.* In addition to encouraging developers of new private free zones to include plans for a business incubator facility in their project, the DZF and/or the Ministry of Finance can stimulate developers to create zone affiliated subcontracting and shelter programs. Frequently, foreign companies considering a direct investment in a country will first engage an existing firm on a subcontract basis. Alternatively, if a shelter program is available, a foreign firm has the option of renting a prepared workforce in a fully serviced building, and sending in only its unique production equipment. The capability for "testing the waters" is especially important in maximizing response from firms in non-traditional sectors, such as electronics assembly or information processing operations, which may be reluctant to risk a major direct investment if it will be the first company of its kind to do so in a country. Zone developers can work with local business leaders to set up subcontracting or shelter operations, and refer to these affiliated enterprises the prospects generated in the course of marketing the zone to overseas firms. Potential actions by the DZF and/or the Ministry of Economy and Finance in support of zone-affiliated subcontracting/shelter plans might include approaching international development programs for funding

and technical assistance in the following areas: preparation of orientation materials on subsector-specific business opportunities; matching resources for feasibility study/prospectus development; identification of potential overseas partners; and assistance in designing introductory offers for major customers (e.g. low-cost electronics assembly, data entry, and/or CAD digitizing).

6.24 *Incentivizing institutions concerned with free zones (and the export sector in general).* As a means of incentivizing the Customs Service as a whole to work towards a successful EPZ program, consideration should be given to introducing performance-linked budgeting. The Free Zone draft legislation of St. Vincent, for example, provides that the Central Government will dedicate new resources to a Customs Administration Fund for bonus payments to employees, or for new equipment and training of Customs personnel, in increments proportional to the total number of firms doing business under the free zone regime. A similar approach might be applied by Uruguay.

6.25 *Upgrading educational and training systems.* Establishment of market-sensitive educational and training systems will be especially critical to Uruguayan free zone competitiveness in emerging technology-intensive areas. The Government should explore new partnership opportunities between the private and public sectors, including solicitation or inputs by incoming technology-intensive firms in the curricula and types of equipment used. Work-study opportunities for students in such free zone firms should be promoted, as well as guest lectures by zone employers regarding the expectations of the marketplace. In the area of informatics, universities and technical institutions could revise their curricula to reflect the growing world market demand for programmers skilled in object oriented programming languages, UNIX, C language, and hypertext and relational data base development. Similarly, microcomputer graphics software and hardware systems should be made available in Uruguayan training institutions, reflecting the rapid growth in world-wide utilization of graphical interfaces and desktop publishing services. Moves could also be made to offer Dvorak keyboard training (increasing the competitiveness of Uruguay in data entry and office support services markets) and to enhance training programs in foreign languages. On a systematic basis, public sector technical training programs in new technology areas could also be given incentives to closely match their needs to those of the market, by such means as linking budgetary increases to the numbers of graduates of each institution taking and holding jobs in the free zone sector.

6.26 Assuming that marked declines are forthcoming in international telecommunications costs, the Uruguayan free zone program could also catalyze new "distance learning" linkages with overseas technical and engineering institutions. Uruguayans who presently leave the country to obtain advanced technical skills would have the option of taking short courses or degree programs

with institutions such as Stanford University and Georgia Institute of Technology. At hundreds of corporate locations in Europe and North America, such broadcast courses are now regularly received at low cost. The courses are "live," permitting interaction among the participants, and course materials are distributed electronically in advance of each class. The ability of participating members of these networks to videotape these state-of-the-art courses makes them available widely for others to access in a given community.

6.27 If the Government of Uruguay wishes to encourage free zones as the leading edge of the economy's integration to the world marketplace, the Ministry of Economy and Finance should actively support private zone applications that make provision for free zone affiliated "Centers of Excellence." As implemented in the United Kingdom, the U.S., and elsewhere, these centers create a network of internationally-recognized resources for business development in targeted, technology intensive market segments. North American, European, or Far East universities with acknowledged leadership in a sector (e.g. electronics, information processing, agro-industry) might prove amenable to affiliating with Uruguayan zones or zone-related institutions. A program of seminars, workshops, and fellowships might be attractive to such institutions, particularly if the private zone developers were willing to dedicate a token share of their earnings to such programs. The existence of such relationships would demonstrate to foreign investors that knowledgeable institutions had already looked over a given zone and given it a seal of approval. The relationships, moreover, will help to minimize concerns from companies in targeted sectors about the availability of needed skills in Uruguay. Efforts by Uruguayan free zone developers to establish world-class free zones thus could be enhanced.

2. Development of Business-Like and Knowledgeable Promotion Institutions

6.28 It is essential that the promotion of the free zones program be undertaken as a joint activity between the public and private sectors, on a businesslike basis respecting the comparative advantages of each. The following steps can be taken to develop a comprehensive free zone promotional capability toward this end.

6.29 *Definition of complementary public/private sector roles in marketing/promotion.* At the outset, the DZF and/or the Ministry of Economy and Finance should identify a national-level organization with the existing capability (or potential) to present the overall free zone program to the world market. Normally, as a regulatory oversight organization, the DZF itself would not be considered a primary candidate for this responsibility.

6.30 The principal institutional objective of the chosen national investment promotion organization is normally to promote exports

and new investment in non-traditional export sectors, including, but not limited to, free trade zones. When established as a public sector organization, it is frequently given autonomy and exemption from public sector salary constraints to attract first-rate staff. Frequently, the organization will employ sector specialists with direct business experience, to answer the operational concerns of overseas firms. Private sector bodies affiliated with organizations such as Chambers of Commerce sometimes assume lead responsibilities.

6.31 Simultaneously, private zone developers should take an active part. Typical responsibilities of the free zone developer include preparation of basic promotional materials on the zone, and assistance for investors during their tour of the site. In some cases, the zone developer also initiates direct contacts with potential tenants through engagement of promotional representatives overseas. The most powerful contribution to zone marketing success that the developer can make, however, is to ensure that the initial tenants in the zone are satisfied with the conditions they find. The endorsements of existing occupants surpass those of all others in the weight they carry upon location decisions by later investors; dissatisfied tenants will deter future foreign investors from locating. The zone developer should thus go the "extra mile" to ensure that concerns of the initial occupants of the zone are treated with exceptional responsiveness.

6.32 *Creation and maintenance of current data bases on investment conditions.* All organizations concerned with free zone development can benefit from the establishment of data bases with current information on business conditions. In countries with effective free zone promotion efforts, these data bases identify specific competitive advantages and disadvantages of the national free zones when compared to alternative investment locations. By determining those areas where the project enjoys a competitive edge on an ongoing basis, the national free zone initiatives can persuasively demonstrate their advantages.

6.33 Concurrently, it is essential that the national investment promotion program staff "know their product" and its competition. They should secure both primary and secondary information on such factors as:

- zone regulatory, legislative and institutional framework;
- cost, quality and availability of the basic production factors available to zone users (labor, land and buildings, basic infrastructure and services, business support services, etc.);
- the changing relative endowments of regional competitors in each of the above areas and the orientation and extent of their own promotional efforts.

6.33 In addition to systematic data gathering from reference

materials, some national free zone programs have taken steps to acquire first-hand familiarity with the free zone policies and programs of regional competitors. Toward this end, field missions have been undertaken by their representatives to examine successful free zone projects in other Latin American and Caribbean countries, including Costa Rica, Jamaica, and the Dominican Republic. To the extent that resources permit, similar initiatives will be highly useful for all institutions with a stake in the success of the Uruguayan free zone program.

6.34 *Training of promotion representatives.* The most successful promotion staffs undertake the training needed to develop the informational data base discussed above. The staff should also audit any training programs developed to streamline the Government permit approval process. Promotional representatives must become familiar with all aspects of zone development, from the regulatory framework, through the facilities and services provided, to the operational processes of the firms which will occupy the project. The development of this institutional capability should be a natural adjunct to the program of data collection, market analysis and investor assistance that the national investment promotion program now provides. A number of programs have found it useful to include a representative in one of the several free zone training programs that are offered by the Shannon, Ireland Free Zone and the World Trade Institute of New York.

6.35 Similarly, zone developers also regularly send promotional staff members (and/or zone managers) to training courses on direct promotion, as well as on responding to the principal concerns of zone tenants, including building and grounds maintenance, personnel recruitment and labor relations, transportation services, and utilities.

6.36 *Tracking systems.* An essential part of institutional development in successful free zone programs consists of Investor Tracking Systems. Whether manual or automated on microcomputers, they enable the interested parties at any moment to ascertain the status of specific investor prospects and the follow-up actions needed. National investment promotion programs in the Dominican Republic, Costa Rica, and Jamaica have already installed computer tracking systems with thousands of entries of investor contacts.

3. Selection of Cost-Effective Media

6.37 As also noted previously, the most cost-effective channels for contacting potential investors/subcontractors seldom resemble high profile advertising campaigns. Instead, key roles are played by free publicity in international business media and of endorsements/referals from satisfied free zone tenants, and on a sustained presence in targeted trade events and advertising media.

6.38 *Developer-targeted programs.* Once clear decisions have been reached by the DZF regarding criteria for privatizing the present public sector zones, and authorizing new zones, immediate steps

should be taken to promote partnerships between local and foreign developers. Experienced overseas developers can bring a number of strengths to private Uruguayan free zone projects. Beyond acting as a source of investment capital, such partners can provide planning, management, and promotional assistance. Considerable potential appears to exist for North American, Far East, and European developers to explore such joint venture relationships. The DZF and/or the Ministry of Economy and Finance can promote such collaborations by sponsoring initial contacts with members of the U.S.-based National Association of Office and Industrial Parks, and helping to arrange visits to Uruguay by interested parties. In some instances, contacts may be warranted to firms other than office and industrial park developers; GTE, for example, has invested millions in private free zone projects in the Dominican Republic. Finally, the political turmoil affecting China makes it distinctly possible that Hong Kong developers would be receptive to similar approaches concerning possible joint ventures with Uruguayan zone developers.

6.39 *User-Targeted Programs.* The active marketing program should promote Uruguay's potential in the industry sectors showing greatest interest in the market survey. These include Certificate of Origin-sensitive assembly and manufacturing industries now based in Brazil and Argentina, as well as Uruguayan firms seeking to enter neighboring markets under bilateral and regional trade agreements. In promoting Uruguayan zones to European and North American markets, an emphasis should be given to companies seeking to produce or source woollen clothes, leather products, low-weight/high value items (precision machinery and specialized electronic components and finished products) and telecommunications-sensitive informatics services. Far Eastern firms concerned about protectionism in world markets, especially in the textiles sector, are also strong candidates for direct free zone promotion efforts.

6.40 As a first step in making contacts to end users, free zone developers should establish a promotion theme that sums up their distinctive advantages. A decision should then be made as to whether to undertake "shotgun" marketing and "rifleshoot" marketing. The first entails actions designed to increase the overall awareness of the project among firms that are likely to locate operations there. This may be done through advertising and articles in trade publications. The more focused rifleshoot approach typically means generation of direct contacts through trade conferences or referrals by companies with an existing presence in Uruguay. Promotional activities such as direct mail or telemarketing campaigns may be conducted either in a shotgun (low-cost contacts with great numbers of firms) or in a rifleshoot manner (high-quality contacts with selected firms).

6.41 Once these decisions have been made, the free zone promotion manager can decide how best to invest scarce resources in various marketing channels. The primary media options are as follows:

Business Conferences/Industry Shows. The primary value of such events is to make multiple personal contacts. The most common shortcoming of this approach is the problem of finding sector-specific conferences that are worthwhile in the sense that company decisionmakers will attend.

Special Workshops/Seminars. Some free zone promotion programs have sponsored such events in order to attract a specific audience. However, staging such events may be expensive, and those most likely to attend may be those who already have an interest in doing business in Uruguay. The advantage is that contacts that are made in this way are generally already very interested in the local environment, and thus have a potentially high probability of coming to fruition.

Industry Conference Booths/Hospitality Suites. Including free zone information in national investment promotion program displays is a simple, inexpensive source of visibility.

Telemarketing. This approach offers a direct personalized channel, which can also be cost-effective, especially if performed from a U.S. base. (One full-time employee can often successfully complete eight to ten marketing calls in a day.) The keys to a successful telemarketing effort are to know who in the target organization to reach, and how to open, direct and close a phone contact effectively. A follow-up letter with support information should be sent within 48 hours of each successful call. At such time as affordably priced, teleport-based international communications are available to Uruguayan free zones, it may prove highly effective to undertake telemarketing to U.S. and European firms from Uruguay directly.

Direct Mail. Direct mail is done best when used in connection with telemarketing or when announcing a specific event (e.g., a seminar on investing in Uruguay). Direct mail contacts should include any favorable news clippings, as well as standard brochures and/or sectorally targeted literature.

Advertising. Costly one-time ad campaigns in general business media usually have little benefit. Instead, the national investment promotion program and/or free zone developers should place small ads repeatedly in inexpensive outlets reaching the specific target sectors.

Free publicity. Among the most desirable kinds of marketing is free publicity. This may be encouraged by nurturing contacts with publications and journalists that cover Latin America or industry sector trends, and by calling their attention to positive news events, such as an opening ceremony for a new Uruguayan zone. Accordingly, the national investment promotion program should encourage favorable articles in general and business press in the U.S. and Europe (including interviews with pioneering Uruguay-based

firms for appearance in trade and general publications, features on existing/imminent sector opportunities, and items for newspapers read by Uruguay expatriates who might consider investing in the new opportunities).

6.42 *Development of professional presentation materials.* Creating quality presentation materials at affordable prices is a further area of importance in a cost-effective promotion campaign. The following rules of thumb have proven useful:

Brochures and information kits. The choices to be made in this regard will depend greatly on the projected zone marketing budget for the first few years. Even if the zone developer is operating with minimal funding, he should plan to spend around \$10,000 on the production of a color brochure. This brochure should be compatible with national investment promotion program materials about Uruguay. These general information items can then be included with the brochure in a folder to make up, for all practical purposes, a complete information kit. Therefore, in preparing the brochure an effort should be made not to unnecessarily duplicate information already contained in materials that will be included as companion pieces. Design of the kits should be modular, with items appealing to one audience interchangeable for items that may appeal to another group. An effort should also be made in the design and writing of such materials to allow for future updating.

Advertisements. Effective display advertisements have the following attributes: 1) they convey the theme at a glance, 2) they present information in a clear, straightforward manner, and 3) they project an image of professionalism. The actual production of "camera ready" material for advertisements in trade publications need not be a costly item. The typical cost of running a one-page display ad in a trade publication with a circulation of 30,000 is about \$3,000, or \$4,000 for a color ad. Some economies of scale (5 to 10 percent) can be realized if such ads are run more than twice.

6.43 *Direct client contacts.* The most important marketing contact with potential clients is the first face-to-face business meeting. This session should convince the prospective tenant that Uruguay is serious about reaching a mutually beneficial business agreement. The promotion representative should be able to explain clearly the advantages of locating in the zone, including space rent, services, incentives, etc. He should also be prepared to respond readily to any questions or concerns raised by the prospective client.

6.44 *Site visit assistance and followup.* The key to conducting a productive initial site visit is to coordinate all logistics properly. Prospects should be greeted at the airport; hotel accommodations should be arranged before driving clients to the

zone. Staff should be prepared to meet clients and assist in showing them around facilities, explaining various features of the site. The tour should be followed by a private discussion in which any questions that have not already been raised should be addressed. Finally, such a visit should incorporate a relaxed social events when appropriate.

6.45 The investor tracking system should remind the promotion program promotion officer at regular intervals following the site visit to ensure routine followup with those who are considering a commitment. Information about the company should be keyed to a method of rating the strength of the prospect's interest, which should in turn dictate how followup activities are conducted. The zone marketing representative is then responsible for updating these information files and for assuring that followups are made, either in the form of phone contacts or business letters.

6.46 *Creation of mechanisms to ensure that zone developers and users remain satisfied.* Given that the most powerful and cost effective promotional media consists of "word of mouth" from satisfied users, the final key to a successful free zone marketing strategy for Uruguay will be a forceful institutional advocate for free zone operators and users.

6.47 Users and developers of free zones in Uruguay are likely to run into obstacles that may from time to time impinge upon their operations. Accordingly, the DZF and/or the Ministry of Economy and Finance should give highest priority to the mission of troubleshooting for the free zones of Uruguay. Its leadership in amending the free zone legislation uniquely qualifies it for such a role. To the extent deemed desirable, the DZF and/or the Ministry of Economy and Finance might take responsibility for organizing associations of free zone users and developers and for serving as their voice in day-to-day matters with the National Government. Beyond taking responsibility for tactical troubleshooting, the DZF and/or the Ministry of Economy and Finance can become an ongoing source of strategic policy initiatives to assist private zone development. This will help to preserve Uruguay's present status as the sponsor of what is one of the most attractive free zone statutes and set of implementing regulations in the world.

VII. RECOMMENDED ACTIONS

The actions presented in this chapter are recommended for public and private sector Uruguayan institutions seeking to remove obstacles that constrain free zone development in the country at present. New employment and export earnings will arise as the market responds to the reduction in deterrents to investment.

A. PUBLIC SECTOR ACTIONS

1. Ministry of Economy and Finance

The Ministry of Economy and Finance should address six constraints as a matter of highest priority.

i. An Unclear Mandate for the Direccion de Zonas Francas

At present, the DZF appears to be inundated with zone-related demands, while lacking clearly-defined domains of control and adequate financial and human resources. The Ministry of Economy and Finance should delineate the jurisdiction (including increased operating autonomy) of the DZF in two paramount areas.

The first primary area of responsibility should be the supervision of the incentives regime, including approval of investor applications and the monitoring of investor compliance with zone legislation and implementing regulations. At present, the DZF has advisory rather than actual powers.

The second primary mandate should be the responsibility for seeing that Uruguayan free zones function on a business-like basis. As discussed further in section (iii) below, this will require the Ministry of Economy and Finance to make an expeditious decision regarding the Colonia and Nueva Palmira zones. If the Ministry wishes the DZF to retain ownership and operating responsibility, it should:

- immediately allocate the resources needed to complete essential infrastructure and to establish an on-site management presence to deal with the problems of zone users; or
- give power for the DZF to seek bids from well-financed and reputable private developers, and sell or lease the zones to investors willing to make the necessary improvements on an accelerated basis.

If the latter course is chosen, such an opportunity may prove both timely and attractive to major Hong Kong developers, who are comfortable with government land leases of less than 15 years duration, and who are extremely apprehensive about their future with China.

A third defined area of responsibility for the DZF should be "investor reception." As a reinforcement to national investment promotion incentives, the DZF should be prepared to give visiting foreign investors (and interested Uruguayan firms) professional presentations on the free zone program and business conditions relating to operational and pending free zones.

A fourth responsibility for the DZF should be advocacy of free zone users and developers interests vis a vis other public institutions. In addition to "trouble shooting" day-to-day problems that may arise with Customs, UTE, etc., the DZF should develop an anticipatory analytic capability, identifying future bottlenecks (such as transport congestion and utilities overloads) before they occur, and recommending preventive action. A related function should be to monitor closely free zone innovations adopted in other countries, and to recommend appropriate policy innovations to help Uruguayan zones remain competitive.

ii. The Slow Pace of Investor Application Approval

The Ministry of Economy and Finance should adopt a Singapore-style investment approval process located within the DZF, enabling all export firms that meet basic conditions to qualify for zone incentives in a single afternoon. (In Singapore, the incentives are rescinded and penalties applied in the event of substantive misrepresentations by a firm of facts when submitting its registration form.) Alternatively, the Ministry should delegate to the DZF full investment approval authority as a "one-stop shop", with automatic approval of each application in 10 days unless the DZF specifically disapproves the application during this period. The criteria for obtaining Certificates of Origin should also be more clearly promulgated. Adequate resources should be budgeted for the DZF to rapidly verify information provided by applicants, under any circumstance.

iii. Inadequate Infrastructure/Management of Colonia and Nueva Palmira Zones

The most crippling immediate obstacle to free zone growth in Uruguay consists of physical and management problems with the existing free zones. The pace of infrastructure improvements is badly lagging behind the needs of existing tenants, as well as of more than two dozen new firms that have expressed a desire to invest. As noted previously, it is recommended as a matter of highest urgency that the Ministry of Economy and Finance either a) provide resources for the DZF to complete vital infrastructure in a timely manner or b) authorize the DZF to announce an international tender to divest the zones to private developers at high bidder. A "debt for leasehold" conversion might be offered as a non-inflationary debt swap to the private developer, assuming Central Bank concurrence. It is highly recommended that the DZF enter into agreements with private property management firms for rental collections and tenant services, in the event that private

developers are not attracted by the privatization offer. In many cases, privately managed zones have doubled or tripled revenue flows from tenants, by offering more rigorous collection of rents and higher standards of service and of amenities.

iv. A Lack of Specialized New Private Zones

Elsewhere in Latin America, private developers have successfully created specialized free zones for technology-intensive export operations, including software, computer-aided design, data processing and bio-engineering. Despite the favorable provisions of Uruguay's free zone act (especially in regard to provision of private utilities for such sectors), no such zones are today operating or under development in Uruguay.

The primary constraint limiting growth in these sectors appears to be the absence of guidelines from the Government regarding the criteria to be used in evaluating proposed new private free zone development projects. Until the Government sends signals that dispel uncertainty in this regard, it is uncertain as to whether foreign investors (including teleport developers) will invest significant resources in Uruguayan pre-investment studies.

This obstacle can be readily overcome through a decision by the Ministry of Economy and Finance to announce its intention to designate within 6-12 months one or more new private zones" under private ownership and operation. Proposals would be invited from both foreign and local development groups. Announced factors in evaluating the proposals could include the financial strength and development experience of the project promoters, the amount of resources being committed, the timetable for development, the provision of specialized facilities/amenities for technology intensive sectors, and the extent to which Uruguayan entrepreneurs are affiliated with the zone as beneficiaries of subcontracting opportunities generated by free zone marketing efforts. Countries such as the Dominican Republic, Costa Rica and Mauritius have found numerous private developers ready to risk their capital when given clear guidelines by Government regarding zone designation criteria.

v. A Lack of Effective National Free Zone Promotion

Although international investment promotional campaigns have paid substantial dividends for many free zone-sponsoring countries, Uruguay has yet to mount a similar comprehensive or effective initiative on behalf of free zones. A first step toward this should be the designation of a business-like organization capable of professionally representing the investment and trade opportunities of Uruguay.

Once the lead agency has been designated, the Government should be prepared to mobilize at least \$1.5 million over a three year period to fully launch the campaign, including the hiring and training of a 5-7 person staff and the opening of offices in North

America, Europe, and the Far East. If the Government wishes to engage the services of a technical assistance provider during the start-up period, it can prepare a request for proposals and circulate this among specialized international firms.

In addition, the Ministry of Economy and Finance should work closely with the Foreign Trade Office to ensure that its overseas representatives are familiar with the free zone regime, and are kept up to date with free zone-related promotional materials.

An essential factor in timing the start of new foreign investor contacts will be resolution of the investor approval, infrastructure and management bottlenecks now crippling the Uruguayan free zone program. The frustrations felt by foreign investors today seeking to establish operations in Uruguay zones will be multiplied with the advent of active promotion and with the ensuing increased backlog of prospective zone users. Until the existing constraints and backlogs can be removed in a systematic way, it is best to forego promotional campaigns that risk damaging Uruguay's credibility with new investors.

vi. An Absence of Performance-Based Budgets for Export Sector Institutions

At present, no clear financial reward exists for public sector organizations to contribute systematically to Uruguayan free zone success. A decision by the Ministry of Economy and Finance to explicitly link the budget of certain key government institutions with objective measures of zone growth could be useful in reducing bottlenecks now encountered by investors with Customs, ensuring standardization of Customs procedures with those of the DZF regarding inflow and outflow of zone merchandise. A similar results-driven rewards policy should be implemented with infrastructure providers, as well as with DZF management, of the existing zones. A similar approach to funding zone-affiliated skills training programs might be useful in encouraging public sector institutions to reorient their curricula and instructional techniques in ways valued by world markets; their budgets could rise or fall in proportion to the number of graduates finding and keeping jobs in zone firms.

2. Direccion de Zonas Francas

Assuming that the mandate of the DZF is clarified along the lines suggested above, the DZF should apply its financial and human resources in overcoming the following specific obstacles.

i. Delays in Investor Appraisals/Monitoring

To expedite the process of conducting background investigations of firms, the Direccion should augment its staff and acquire the equipment minimally needed for this purpose. Designated individuals should be made responsible for requesting credit

ratings through international data bases (such as Dun & Bradstreet), as well as to request police record investigations in the investor's country of origin. A 2400 or 9600 baud modem and a Group III facsimile unit will be essential for rapid and cost-effective access to the needed information.

ii. Removal of Developmental Bottlenecks for Colonia and Nueva Palmira Zones

If a decision is made to privatize the existing public sector zones, the DZF should first prepare free zone profiles summarizing for each zone their existing facilities and onsite and offsite infrastructure, their financial performance, their current and pending tenants (including rental payment history), their current physical configuration (including maps and photos), and the provisions of their tenant lease agreements. Advertisements should then be placed in national, regional, and international publications inviting tenders from experienced private development groups for the purchase (or long-term lease) of the zone properties. The appearance of these advertisements should be timed to coincide with seminars organized by the DZF in Uruguay, North America, Hong Kong, and Europe to provide background information on the zone development opportunities.

In the event that the Government of Uruguay decides to retain operational responsibilities for the existing zones, it should take the following steps to remove existing developmental constraints:

- introduce new financial incentives for the zone managers proportional to their success in maximizing lease revenues for the DZF (this could be accomplished by introducing a new internal reward systems for DZF managers or by contracting out with one or more private property management group);
- survey all zone users periodically for their views on priority zone development constraints to overcome, as input to the one-site zone management personnel in their operations and to the DZF in budgeting;
- contact once-interested firms that decline to follow through with Uruguayan zone investments regarding the reasons for their negative decisions; and
- provide for an automatic membership association of zone tenants (through mandatory membership provisions in the standard zone lease contracts), with self-assessing powers to finance improvements desired by zone occupants.

iii. Lack of Foreign Investor Awareness

Once the bottlenecks now limiting the availability of zone space have been removed, the DZF should work closely with the national

zone investment promotion organization in its planning of zone-related promotional campaigns. In particular, representatives of the DZF should be included on planned overseas promotional tours to North America, Europe, and especially the Far East, where investors value the chance to hold meetings with decisionmakers responsible for investment incentives.

iv. Inadequate "Investor Reception" Capability

At present, the DZF lacks sufficient resources to provide interested foreign and regional investors with a comprehensive orientation regarding free zone-related opportunities. One or more fully bilingual individuals within the DZF should be assigned responsibility for receiving potential investors who request such briefings. Although adequate promotional literature already exists, the DZF should seek funding to equip a special conference/presentation room with all needed background materials on the free zones, forms necessary for obtaining utilities and permits, current cost information on factor inputs, directories of local vendors, and economic data regarding local and regional investment, import and export trends. A slide or video presentation system should also be prepared to orient visitors about Uruguayan free zones.

v. Lack of Policy Analysis/Problem Resolution Unit

The rapidly changing environment for free zone industries -- both within Uruguay and other countries -- makes it essential for the DZF to closely monitor initiatives by competitors and to anticipate/rectify problems that may arise with firms operating in Uruguayan zones. At a minimum, DZF should plan (at intervals of one or two years) visits to competitive countries such as the Dominican Republic and Costa Rica. An inhouse research capability should be developed also to monitor signs of strain on Uruguayan infrastructure and basic services, and to suggest remedial policies that could be adopted before disruptive effects are felt by free zone-based industries. Finally, the DZF should encourage free zone managers and tenants to immediately report problems arising from interactions with Customs, local officials, or others -- an effective troubleshooting capability is essential to maintaining high levels of tenant satisfaction.

B. PRIVATE SECTOR ACTIONS

1. Potential Uruguayan Zone Developers

In coming months, prospective zone developers in Uruguay should consider taking the following steps to familiarize themselves with zone-related opportunities, and improve their prospects for success:

i. Gain Direct Knowledge of Zone Potentials

- Visit successful private free zones, business incubators, and subcontracting/shelter plan operators. In Mexico, Costa Rica, and the Dominican Republic, a number of examples exist of successful private free zones with a range of related amenities. Meetings and tours of these facilities can shed light on useful strategies and techniques transferable to Uruguay.
- Meet with private utilities providers. International satellite service providers, power generation firms, and port development companies can offer useful guidance regarding the configurations and costs of potential new services for Uruguayan zone developers. The intense competition among such firms makes it feasible for zones to gain valuable insights into the benefits and disadvantages of alternative configurations.
- Meet foreign and local firms in new technology-intensive sectors. Zone developers in some cases may be unfamiliar with the sector-specific needs of firms in fast-growing segments such as electronics assembly and information services. Travel to meet overseas free zone development organizations can often include visits to such firms, for the purpose of identifying their location decision factors and operational requirements.

ii. Clarify Designation Groundrules

Potential private zone developers in Uruguay should also work with Government in coming months to clarify the factors that will be used by the Ministry of Economy and Finance and/or the DZF in designating new free zones (suggested ingredients are presented in Chapter VI).

iii. Mobilize Implementation Resources/Know-how

For developers seeking free zone designations, the following steps can be important in marshalling the information and financial resources necessary for project implementation:

- Prepare preinvestment studies yielding a phased development plan. Leading architectural and engineering firms, as well as specialized free zone consultancies, can be engaged professionally to assist zone developers in project analysis and planning. On occasion, successful overseas free zone developers are also available on a (compensated) consultancy basis.
- Identify potential overseas development partners. Organizations such as the U.S. National Association of Office and Industrial Parks are a source of prospective foreign partners in Uruguayan zone development

organizations. Although most U.S., European, and Asian developers are locally or regionally-oriented, some firms have international holdings and are receptive to joint venture relationships with reputable firms.

- Identify potential overseas marketing representatives. On a fee-paid and on a commission basis, foreign promotional representatives can also be engaged by free zone developers. Although the costs of such arrangements can be high, private developers in Costa Rica and the Dominican Republic have found them capable of generating substantial investments.

2. Potential Uruguayan Zone Users

The prospective users of Uruguayan zones, especially in industrial and in the emerging information industry sectors, should also travel to free zones in other countries to get a sense of how their competitors have fared in free zone environments. If possible, the prospective zone users should undertake market studies to assess in advance the response of external markets to

C. POSSIBLE ROLES FOR DEVELOPMENT ASSISTANCE PROVIDERS

Multilateral and bilateral development institutions have become increasingly supportive of free zone initiatives by developing countries. In Uruguay, the following areas have been identified that may be of near-term interest to such institutions:

1. Support for Public Sector Institutional Development

Steps to create a "one stop shop" within the DZF should prove especially beneficial in stimulating non-traditional export development from Uruguayan zones. Similarly, moves to strengthen the organization's awareness of regional competitors, to add staff and equipment needed to properly receive foreign investors, and to develop anticipatory problem-solving capabilities would yield substantial dividends.

In overcoming existing bottlenecks relating to the supply of free zone space, technical support should be considered either for developing a tender offer for privatization of the existing zones, or for improved management capabilities of public sector zones (such as creating performance-based rewards for present zone management personnel or contracting out property management functions).

2. Support for Opportunities Assessments

Technical support should be also considered for the Uruguayan zone developers and potential user firms that would like to familiarize themselves with the experiences of counterparts overseas. Rather than fully subsidize the costs of international travel to see

successful private free zones and their technology-intensive occupants (including shelter programs and subcontracting operations), matching resources might be provided towards this end. Alternatively, a seminar on emerging free zone trends could be sponsored for Uruguayan developers and users.

3. Assistance With Preinvestment Studies

For free zone developers and non-traditional exporters, matching grant funds might also be made available to assist in market studies and feasibility analyses. In other countries, comprehensive free zone feasibility studies for multilateral development agencies have cost from \$200,000 to \$350,000. The cost can be significantly reduced, however, through paring back the number of firms surveyed as potential zone occupants, and through use of local rather than overseas engineering firms.

4. Support for National Investment Promotion Efforts

Once the Uruguayan free zone "product" has reached world-class levels -- i.e., through simplification of investment approval procedures, the enhancement of existing zones, and/or the decision to designate new privately-owned and operated zones -- the commitment of substantial external resources for a new national free zone-oriented promotion institution will generate substantial returns. Investment promotion organizations in the Dominican Republic, Costa Rica, Jamaica, and elsewhere have proved remarkably successful in attracting firms to their respective countries' free zones. Given the intrinsic elements for free zone success already present in Uruguay, commitments by the public and private sectors along the lines suggested above should rapidly move the country's zones to a leading place in the competitive global market.

BACKGROUND NOTES TO THE REPORT

The PEDS Project

This study was conducted under the Private Enterprise Development Support Project. The PEDS Project is a five year (FY88 - FY92) \$20 million project managed by the Bureau for Private Enterprise. The PEDS Project is designed to provide a wide range of expertise in private sector development. Areas of technical assistance include the following:

- Policy analysis related to private sector development;
- Sector assessments and analyses;
- USAID private sector strategy development;
- Legal and regulatory analysis and reform;
- Small-scale business development;
- Trade promotion;
- Investment promotion;
- Free trade zone development;
- Financial institutions and instruments;
- Management and financial training;
- The role of women in private enterprise; and
- Applications of MAPS: Manual for Action in the Private Sector.

USAID Missions have the resources of thirteen contractors available to them through the PEDS Project.

- Arthur Young (Prime)
- SRI International
- Management Systems International
- The Services Group
- Trade and Development, Inc.
- Multinational Strategies
- J.E. Austin Associates
- Ferris, Baker, Watts, Inc.
- Metametrics
- Elliot Berg Associates
- Robert Carlson Associates
- Ronco
- Dimpex Associates

The Consultancy

This study is intended to provide the Direccion de Zonas Francas of the Ministry of Economy and Finance with a strategic framework for more fully realizing market opportunities for the Uruguayan free zone program. The project is a response to passage of free zone statutes in late 1987, and to implementation of needed regulations in mid-1988, which have created substantial opportunities for new private sector roles in the financing, management and marketing of zones in the country, as well as in the

on export processing zone programs in the Dominican Republic, Costa Rica, Jamaica and Barbados and contributed to assessments of the role of the private sector in zone development in the Caribbean region. She has also participated in feasibility studies for private export processing zones in El Salvador, Uruguay, Togo and Cameroon. Ms. Bryk holds a B.A. in Political Science from the State University of New York at Geneseo and is currently pursuing a Masters in International Affairs at George Washington University.

ANNEX A

SECTOR PROFILES

Annex A-1

APPAREL MANUFACTURING AND ASSEMBLY

Apparel manufacturing and assembly firms are among the leading users of free zones worldwide. The size and growth trends of the industry, coupled with the internationalization of production and assembly, have made the apparel sector an important contributor to the growth of export manufacturing in developing countries.

Apparel is generally classified by a description of the garment (e.g. men's suits, dresses, sportswear, etc.), with product groups further defined by fiber content. Apparel goods are also categorized as finished or unfinished. Finished goods comprise all end-product garments ready for wholesale or retail delivery, while unfinished garments are apparel pieces and cut components ready to be assembled or attached.

Global Trends in Apparel Production

Apparel manufacturing and assembly technology has experienced slower rates of technical alteration than other internationally diffused industries such as electronics manufacturing. Many of the significant changes in technology have occurred only recently, and primarily in high-end industry sectors of the United States, Japan, and other industrialized countries.

The principal gains in technology have affected sewing machine speed and accuracy, and control and management of pre-assembly activities (electronic marking and cutting, for instance). Yet, such advances have had a minimal impact on reducing overall production costs; industry analyses indicate that approximately 85 percent of the typical apparel worker's time is spent handling garment components, rather than actually sewing. Given that labor accounts for an average of 35 percent of an apparel product's value, heightened labor productivity is still the key to increased profitability, especially in high-wage countries.

Production strategies of the apparel industry are changing as well. Twenty years ago, Hong Kong, Taiwan, South Korea, and Japan -- dominated apparel exports. Today, production of apparel is globally disseminated, and the production strategies of established apparel manufacturers have been adapted to reflect the industry's growing mobility. The increasing number of producers establishing apparel offshore facilities results from several economic and technical factors. The movement has been encouraged by the advent of manufacturing techniques which have permitted separation of the production process in time and location without affecting end-product quality. On the other hand, manufacturing and assembly by offshore producers is a natural outgrowth of the dramatic increase in the unit cost of developed country labor, materials, and overhead, thereby reducing the competitiveness of facilities in these locations.

In general, apparel products best suited for offshore production share the following characteristics: high labor content-to-weight ratio; simple design; low line diversity; smaller production runs; low brand name identification; decentralized cutting and parts preparation; minimal capital investment requirements; stable production parameters; and infrequent in-season reorders. The most important factor, arguably, is the labor cost-to-weight ratio. If a product's labor content is relatively high, and its shipping weight relatively low, that ratio will generally favor offshore production regardless of other factors. As a rule, a product with a high labor component can be made in an offshore location at a cost savings high enough to more than offset by lower transportation costs or higher productivity in developed country markets paying higher wages.

Market Structure and Primary Trade Patterns

Overview of World Trade. Growth in the value of world trade in textiles and apparel accelerated an estimated 27 percent in 1986, fueled by increased consumer demand in the United States (6.5 percent) and in the EC (3 percent); a recovery in the growth of exports from the Far East; and the effect of exchange rate fluctuations on the unit values of apparel products traded in, and expressed in, dollars (depreciating). Total worldwide imports equalled US\$62 billion in 1986. Import value growth, on average, outpaced export growth in the two largest markets in the world -- North America and Western Europe, which together consume 80 percent of all apparel goods exported globally. World trade in clothing during 1986 not only expanded twice as fast as total merchandise trade, but also faster than the 20 percent increase in world exports of manufactures.

In value terms, over three quarters of world apparel exports originate in Western Europe, China, Hong Kong, South Korea, and Taiwan. Despite year-to-year fluctuations in the 1980s, the four leading East Asian economies have captured increasingly larger market shares of world trade, with corresponding declines in those held by Western Europe and North America. The market position of developed countries has been continually eroded since 1970.

The developing countries' share of total worldwide exports reached 12 percent in 1986, basically unchanged since 1980. The principal markets for apparel exports from LDC's are North America and Western Europe, with over 75 percent of LDC production destined for these two markets. Only 10 percent of production in developing countries is traded intra-regionally.

In 1986, the market share held by LDC's had expanded to 23.5 percent of total imports into North America and 11.5 percent of total West European apparel imports. In contrast, LDC imports of clothing (including the oil-exporting nations in the Middle East) have declined since 1983, due in most part to the decline in

demand from Middle Eastern markets suffering from an oil-based recession.

The U.S. Market. The United States is the largest importer of apparel products in the world. The value of apparel industry shipments (both imports and domestically produced goods) in the United States in 1987 totalled over US\$60.9 billion. Apparel imports exceeded US\$19 billion, while only US\$1 billion were exported. Since the 1970s, total domestic consumption of apparel has grown modestly, at less than 1.2 percent annually, during which time the market share of domestically produced goods declined rapidly relative to imports. From 1976 to 1986, import penetration increased from 12 percent to 35.6 percent in value terms.

Particular apparel items have increased substantially with regard to import penetration. In 1986, the dominant imports were sweaters, women's and children's coats, male shirts, blouses, and female slacks. The tremendous inroads made by imported apparel products over the last decade have stimulated structural changes in the U.S. apparel industry to remain competitive, such as:

- U.S. quotas governed by the Multifiber Arrangement (MFA) have been tightened. The United States now has 21 bilateral agreements covering over 90 percent of its apparel imports. In 1987, a 1 percent ceiling was placed on the annual value growth of U.S. apparel imports from Far Eastern suppliers.
- U.S. apparel manufacturers have begun to source, import, and manufacture both apparel components and finished goods from low-cost locations offshore with excess quota availability.
- Far Eastern manufacturers facing the imposition of highly restrictive quotas have moved to other low-cost locations with access to the U.S. market. The immediate beneficiaries of this trend have been the countries of South Asia (Sri Lanka, India, Bangladesh, Indonesia, Thailand, and Mauritius).
- There has been a strong trend in Far Eastern exports away from low-end, low profit margin apparel goods towards higher quality, better styled adult wear in response to quotas on man-made fiber apparel.

The highly competitive environment in which apparel manufacturers are operating is not expected to diminish over the medium term. In the United States and Europe, anticipated demographic changes are expected to fuel growth in demand for all types of apparel products. Furthermore, many U.S. manufacturers are reportedly experiencing substantial cost increases from their Far Eastern sourcing operations due to the declining dollar and more expensive

fabric and labor, and are subsequently devising strategies to protect their market share. Such strategies generally include: investigating low-cost labor locations for expansion or relocation; introduction of more sophisticated technology to reduce labor component of production; and increasing reliance on subcontractors as an alternative to direct investment.

Locational Requirements

Apparel manufacturers establish offshore supply and manufacturing facilities for two basic reasons: to take advantage of low-cost manufacturing and assembly and thus remain competitive; and to secure access to developed country markets, especially the United States, and escape quota restrictions. Any free zone that can satisfy these two requirements is in an excellent position to draw investment from U.S. and Far Eastern apparel companies, regardless of its relative resource endowment in other areas.

Garment manufacturing can easily be established in most low-wage locations and the facilities requirements are minimal. Although some firms will pay a premium to be assured of responsive property management, the typical apparel company faces strong competitive pressures to keep fixed costs to a minimum. For the most part, standard factory buildings, an abundant, competitive labor pool, reliable, affordable ocean cargo service, and market access are all an exporter needs to establish successful operations.

Wages are the most important cost consideration for the industry. Apparel manufacturing is extremely sensitive to labor costs, and apparel products are highly price sensitive at the wholesale level. In addition, the labor force should be easily trainable and able to adapt to alterations in the production process arising from changes in the often volatile consumer market. Apparel manufacturers generally prefer to locate plants close to urban centers with an abundant female workforce and the availability of competent mid-level managers and supervisors is also important. For more remote locations, adequate transportation for multi-shift production is critical.

In general, the utilities and service requirements of the industry are basic. Reliable power transmission is important and any shortcomings in the electricity supply must be supported through back-up generators. Good telecommunications service is also important to certain types of apparel manufacture, especially for firms specializing in short production runs. Most garments are shipped by sea and the cost, and reliability of ocean freight services, and access to the port are key concerns for the industry. For the few items shipped by air -- principally more expensive, fashion-sensitive items -- reliable air service is crucial.

Annex A-2

ELECTRONICS MANUFACTURING AND ASSEMBLY

Electronics manufacturing and assembly firms have played a major part in the evolution and diversification of free zone industrial activity. Zones throughout the world, especially in the Far East, have succeeded in attracting electronics manufacturers after establishing export operations in other industries such as apparel/textiles and light manufacturing.

The electronics industry is comprised of five basic sub-sectors: automatic data processing machines; telecommunications equipment; consumer electronics, electronic components, and business electronics. The product categories most suited for offshore production have proven to be electronic components and consumer electronics, and to a lesser extent telecommunications equipment.

Electronic components are the building blocks for all electronics products, ranging from radios to telecommunications equipment and business computers. Component manufacture involves the production and assembly of either "active" or "passive" electronic parts and intermediate devices (although some components integrate both). Passive components comprise resistors, capacitors, switches, relays, printed circuit boards, and electron tubes. These relatively simple components embody more standardized design and labor-intensive production processes and can be used in many different electronic product applications. For this reason, passive components are well suited to offshore production and are the focus of this profile. Consumer electronics utilizing passive components include radios, cassette players, electronic clocks, television sets, video tape recorders, and telecommunications equipment.

Global Trends in Electronic Production

Large-scale assembly and manufacture of electronics products and components outside North America and Europe began in Japan in the early 1960's. The low cost of labor and the skillfulness of Japanese workers lured industry leaders, as developed country wages rose during the post-war economic boom. While Japan's electronic component and light assembly production flourished, other Far Eastern countries, led by Taiwan and South Korea, followed suit and the production of standardized electronic components worldwide was soon dominated by companies based in the Far East.

The success in the offshore manufacture of electronic components and consumer electronics rests largely on the ability to separate various stages of production, especially labor-intensive processes, as well as the standardization of components and

production technologies. This allows manufacturers to seek low-cost locations for production of components and low-end consumer products, either through direct investment in offshore locations or sub-contracting to a foreign component manufacturer.

The importance of lower production costs differs between product categories. Traditional components and products, such as those used in the manufacture of consumer electronics, are normally characterized by strong price competition and standardized technology. Accordingly, low manufacturing costs are essential to remain competitive in that segment of the electronics industry. Products with a high degree of innovation and specialization are more price elastic with respect to demand, and are marketed on the grounds of product quality, technology, and performance.

Experience indicates that the electronic products most prone to offshore production are those with: a high labor content; straight-forward production processes; high value-to-weight and price-to-volume ratios; and constant design technology in the short term. The electronics products meeting these criteria contain components such as resistors, capacitors, and include simple finished products such as watches, radios, and television sets.

Market Trends and Primary Trade Patterns

Overview of World Trade. Total world exports for all electronics products reached US\$164 billion in 1986, a 21 percent increase in value over 1985. This industry was one of the fastest growing in all world merchandise trade, partially due to exchange rate movements. Although demand declined in West Germany and the United Kingdom, the largest markets in the EC, West Germany nonetheless continued to record the highest level of export and import growth within the region. Among LDC exporters, the marked appreciation of the yen against the dollar improved their competitiveness, especially in standardized consumer electronic products and components which compete directly with Japanese products.

The share of electronic products in relation to total world trade increased from 4.4 percent in 1980 to 7.6 percent in 1986. Outstanding performance occurred in exports of automatic data processing equipment (consisting of computers and related equipment), growing by 24 percent to reach US\$55 billion. Export market growth was led by Far Eastern firms, whose exports grew by over 50 percent. This product category is highly competitive, but relies on innovation and performance, as well as cost. The rate of growth in exports of telecommunications equipment tripled from 7 percent in 1985 to over 24 percent in 1986, reaching US\$28 billion. The exporting leaders -- Japan, the United States, and the EC -- accounted for most of the value growth due to increased worldwide demand (especially in Europe) for all types of equipment.

The value of world exports of consumer electronics expanded by almost 17 percent in 1986 to reach US\$28 billion. Exports from Western Europe and South Korea expanded by nearly 60 percent, while Japanese exports (accounting for more than 50 percent of total consumer electronics exports) grew by less than 5 percent, due to a combination of factors: the appreciating yen, a fall in exports to China and the Middle East, and the impact of industrialized country protectionist measures on consumer electronics from Japan. Responding to these actions, Japanese manufacturers have moved offshore to both industrialized and LDC locations to maintain competitive positions in electronic components manufacturing.

World trade in electronic components (including semiconductors) experienced a marked increase in 1986, as imports recovered by more than 22 percent after a 10 percent decline in 1985. The growth can be attributed to a strong expansion of U.S. exports; and a significantly higher growth for EC imports compared to 1985.

Trade data reflecting actual shipments of goods across borders, rather than treating foreign subsidiaries as part of the parent company's "domestic industry," reveals the importance of LDCs and NICs as manufacturing locations. These countries exported almost US\$6 billion worth of active components in 1986, while the United States, Japan, and the EC exported US\$2 billion, US\$3.1 billion, and US\$3.2 billion, respectively. The industry composition has changed in recent years as developed country firms have forged alliances with offshore manufacturers to reduce costs, solidify market position, and gain access to product markets.

The U.S. Market. The United States is the world's largest market for electronic products and components, with just under US\$11 billion worth of components alone imported in 1987, representing a growth rate of 17 percent over 1986. The increase was largely due to strong demand from the computer and defense industries. The manufacture of components is expected to grow at least 10 percent per annum over the next two years. Approximately half of all U.S. trade is generated from offshore manufacturing in the Far East and Mexico. Indicators for 1988 show that many U.S. manufacturers are now engaged in foreign joint ventures to enhance competitiveness.

The market for capacitors is especially strong, with a projected growth over the next few years to exceed 1987 growth of 5 percent.

The automotive, computer, and telecommunications industries were the biggest end-users of these components in 1987. Shipments of electronic coils and transformers (used in household electronics, computers, etc.) were also accelerating substantially, up 6 percent from 1986 to US\$1.3 billion, most of which originated low-cost labor locations. Growth in U.S. imports of electron tubes, connectors, and resistors will be modest over the near term.

In general, the long-term prospects for penetration of the U.S.

market are excellent. The moderate growth rates for traditional passive components and consumer and business products, coupled with rising interest in offshore manufacturing from U.S. firms, bodes well for LDC free zones as domestic component manufacturing operations are increasingly vulnerable to price competition from the Far East. Moreover, beneficiaries of the U.S. GSP program can receive duty-free market entry on the value-added abroad for certain electronic products and components. Protectionist actions to date have been limited primarily to semiconductors and aimed at Japanese manufacturers; access for LDC exports should remain open.

Locational Requirements

Facility and resources requirements for electronic components and products are more sophisticated than those of apparel and other light manufacturing industries. Consequently, greater attention must be paid to the physical structure and capital investment requirements. Generally, the parent company or contracting firm will supervise the supply of physical plant and equipment to their overseas production site.

Electronics assembly plants and low-end manufacturing facilities can usually be accommodated in standard factory shells adapted to meet tenant specifications. Many medium-end products (certain capacitors, semiconductors, and upscale electronics products) require sterile work areas and a highly controlled environment, and are usually not located in LDC regions. Processes involving testing and assembly often require climate-control, such as air filtration and air conditioning. Singapore and Malaysia, especially, have attracted foreign electronics manufacturers requiring sterile production environments by investing heavily in enhanced facilities and sophisticated industrial parks.

Within the industry, the location of the plant in terms of access to transportation, services, and semi-skilled labor carries significant weight in site selection. Because of the high value-to-weight ratio of electronic components and products they are often shipped by air and proximity to an international airport with frequent, affordable cargo service is an important consideration. Other basic service requirements for the industry include affordable and reliable telecommunications services, with minimal delays for new connections, and an adequate, dependable electrical power supply. Many types of electronics manufacturing require controlled environments, and air-conditioning is often a necessity in tropical climates. If the public power supply is plagued by voltage fluctuations and interruptions in service, back-up generators must be installed.

To compete in today's market, electronics firms require access to an easily trainable, literate workforce. English-speaking managers and trained technicians are an asset for an offshore location, although expatriates are generally used initially.

Annex A-3

FRUIT AND VEGETABLE PROCESSING

Fruit and vegetable processing is a sub-sector of agro-processing, the term used to describe the commercial processing and distribution of agricultural products. The spectrum of activities encompassed is extremely broad, ranging from the simple packaging and sale of primary food products for local cash markets to the large-scale, complex processing and international trade of high value-added products. Given the immense scope of this sector, this profile does not attempt a comprehensive examination, but instead focuses on one type of processing activity: the production of processed fruits and vegetables, including such products as juices, frozen concentrate, and canned products. The processing of fruits and vegetables is one of many agro-activities that can benefit from locating in a free zone, capitalizing on the availability of local raw materials in the production of export goods.

Global Trends in Fruit and Vegetable Processing

Fruits and vegetable processing includes those businesses engaged in the substantial transformation of fruits and vegetables into food products such as canned food, frozen food, packaged dinners and snacks, etc. The successful development of processing activity provides an effective means to capture increased value-added from the natural resource endowment of a production location, and expand markets for local agricultural goods.

In the past, processed food production was dominated by a few industry giants, primarily the same firms which controlled the fresh food industry. Historically, the difficulties inherent in food preservation necessitated the production and consumption of agro-products within the same geographic region. Consequently, in commercial agricultural production, markets were defined by local geographic conditions and transportation networks. With the advent of low-cost refrigeration and increasingly sophisticated food processing and handling techniques, locations possessing comparative advantages in the production of certain food products are now actively trading both semi-processed foods and finished products internationally. This has accompanied a trend towards increased product specialization, resulting in increased productivity, lower production costs, and a concomitant increase in the volume of processed agricultural goods traded worldwide. Fresh products which are expensive and difficult to transport have been transformed or "processed" into export commodities.

Multinational firms are increasingly concentrating in final processing, marketing, and distribution of bulk foods products and rely on brokers and distributors (rather than their own croplands) for their supply of raw and semi-processed goods. These products often originate from small- and medium-sized commercial farms where preliminary on-site transformation is undertaken to bring bulk quantities of the product to a transportable (semi-

processed) state. The bulk goods are then broken down or blended with other inputs, processed further and packaged in smaller containers in locations near the end-market -- grocery stores, restaurants, etc.

The evolution of the production and distribution process has taken place alongside certain changes in the demand for food products in expanding developed country markets. In the United States, Western Europe, Japan and the Far East, rising incomes have enhanced consumer purchasing power. Advances in communications and increased individual mobility have exposed the consumer to a broader range of food choices. As a result, there has been a substantial increase in the variety of products marketed internationally and the demand for new products is on the rise. Tropical produce, exotic spices, sauces and jellies, and ethnic specialty foods are now widely available in stores and restaurants.

Consumers are also becoming increasingly reliant on convenience in food preparation. Sales of convenience foods, such as processed and frozen vegetables, aseptically packaged juices, and prepared sauces are accounting for a rising share of the total market. Technological innovations such as heat processed packaging and quick-freeze techniques are making prepared meals and dishes available to affluent customers worldwide.

As an example, in 1984, total consumption of food products in the United States exceeded US\$300 billion, and fully 50 percent of all food sales were frozen foods. In 1950, processed fruit accounted for 42.8 percent of the total U.S. fruit consumption; in 1982, this figure had risen to 60.2 percent. Corresponding data for processed vegetable consumption in the United States shows an increase from 42.2 percent in 1950 to 50.4 percent in 1982.

Market Structure and Primary Trade Patterns

Overview of World Trade. Taken as a whole, the European Community is the world's largest consumer of processed fruit and vegetable products, followed by the United States. Within the EC, intra-regional transfers, for instance, account for fully 70 percent of EC member nation exports. In 1982, the EC received an estimated 16 percent of non-EC member world exports, and in 1986, it imported nearly US\$5.4 billion in fruits and vegetables.

The principal reason behind the self-contained nature of EC agricultural trade is the regional trade barriers that have been erected to protect agro-producers in member nations. The primary European importer of fruits and vegetables is West Germany with imports of over US\$6.11 billion in 1986, a 23 percent rise in value over 1985 levels; followed by France (US\$3.22 billion), the United Kingdom (US\$3.20 billion), and the Netherlands (US\$2.09 billion). On an individual basis, and for the EC in aggregate, imports of fruits and vegetables are increasing, growing from US\$13.52 billion in 1984 to US\$17.91 billion in 1986, an increase

of 25 percent. West Germany is also the largest EC market for fruit juices with nearly 15 percent of the world total in 1981, followed by the U.K. with 10 percent.

The U.S. Market. The United States is the second largest consumer of agricultural products after the EC, and it is also one of the largest agro-producers in the world. Canned vegetables are the dominant form of processed vegetable consumption, however, although several categories within the sector are thriving (ethnic foods, sauces, soups, etc.) overall growth in the product sector has been stagnant since 1975. On the other hand, fresh and frozen vegetable consumption increased 2 and 3 percent annually, respectively, between 1970 and 1985.

Selected citrus products have led the growth of the processed fruit and vegetable sector. The total use of citrus items has shown moderate growth over the 15-year period relative to other processed fruit and vegetable categories. However, demand for frozen citrus items was much higher, increasing almost 100 percent over the period. Frozen concentrate orange juice grew 4.6 percent annually between 1970 and 1985 and aseptically packaged chilled juice has also recently experienced a significant increase in demand.

The share of the market held by imported processed fruits and vegetables and citrus in the United States is growing. U.S. imported canned foods and frozen foods reached over US\$2 billion in 1987, up 3.5 percent over 1986. In 1987, six products were responsible for 50 percent of the fresh and processed fruit and vegetable imports: orange juice (20 percent), apple juice (9 percent), mushrooms (7 percent), pineapples (7 percent), olives (4 percent), and tomato products (3 percent). Imports are becoming an increasingly larger share of U.S. consumption of processed foods, though at a moderate rate. U.S. imports of citrus products have been aided in the 1980s by several freezes in the citrus groves of Florida which have not only diminished U.S. exports, but increased its reliance on imports for domestic consumption.

Locational Requirements

In general, proximity to, and coordination with sources of production is essential to successful agro-processing operations. This can be viewed from two perspectives. For locally produced agricultural products, the processing operations should be linked to the harvests of the domestic suppliers. For larger scale, regional agricultural transshipment and processing facilities, production requirements and economies of scale necessitate reliable, steady supply of the raw materials and semi-processed goods to be utilized in the processing operation.

As a rule, refrigerated warehouses should be included in the project master plan as a standard facility available to firms within the industry. For some simple packaging businesses, standard factory buildings will suffice for their operations.

However, for those firms utilizing advanced technology, often the best strategy is for the firm to construct facilities at its own expense, within pre-determined structural guidelines, as the specialized buildings may be of little use to any other firm. Many companies prefer locations outside of designated general purpose free zones to realize the benefits of locating their operations close to the source of their raw materials.

Access to an abundant labor supply is less crucial than for other types of free zone industries. For most basic processing activities, manpower skill requirements are minimal and can be satisfied by unskilled labor, although the growing sophistication of the processes and equipment involved in state-of-the-art technologies, gives an advantage to those locations which can supply skilled managers, technicians, and agricultural specialists.

Reliable and affordable power is essential for agro-processing. Local power supply should be augmented by back-up generators if necessary to ensure a constant supply. Many processing operations also require large amounts of water for industrial use and special waste-water treatment. Management should determine the special needs of individual users prior to leasing or constructing facilities to ensure that the demand their operations will place on the system will not overload its capacity.

As in other sectors, good telephone and telex service is important to firms engaged in international agricultural processing and distribution activities. Long delays in installation, intermittent service and problems in overseas dialing can deter investment and frustrate clients who are arranging sales and require frequent contact with suppliers, brokers, and distributors.

Reliable inland transportation services and infrastructure are crucial. In this industry, much more so than in other sectors, it is imperative that there be regularly scheduled and rapidly delivered shipments of the unprocessed goods to the processing facility. Refrigerated trucking, warehousing and shipping services between the source of the goods and the production center is essential. Once the goods are processed, transport time becomes less crucial; however, easy access to a frequently serviced port facility is a must.

Agricultural training and research centers can serve as attractions for agro-processing businesses. In order to remain competitive with large-scale developed country producers, firms must look toward improved crop yields, which translates to increased technical skills for their production specialists. In this manner, not only will the overall quality of the product improve (thus facilitating entry to the tightly regulated U.S. and EC markets) but the workforce will benefit from increased linkages between the schools, the fields and the industrial workplace.

Annex A-4

COMMERCIAL WAREHOUSING AND DISTRIBUTION

Warehousing has long been the dominant form of activity in free zones and it is only recently that manufacturing and services have become the primary generator of zone foreign exchange earnings and employment. In zone warehousing operations, bulk goods are sorted, inspected, and repackaged for retail sales. The zones help minimize costs of product flow to market through duty exemption on goods that are subsequently re-exported and duty deferral, for those goods entering the domestic economy.

Global Trends in Warehousing and Distribution

Traditional activities encompassed by and related to free zone warehousing and distribution have been re-export trade, as well as trade intermediaries such as warehousemen, freight forwarders, trading companies, and the like. In terms of the type of merchandise typically stored in zone warehouses, luxury goods predominate. Free zones are used by these companies as a single supply source serving multiple destinations.

The example of Panama's Colon Free Zone is illustrative. In 1986, the Colon Free Zone conducted \$4 billion in business. Of this amount, the most important sources were Japan (25 Percent), Taiwan (15 percent), Switzerland (9 percent), United States (8 percent), and Hong Kong (7 percent). Not surprisingly, destinations for re-exports were more concentrated within the Caribbean Basin and Latin America: Colombia (17 percent), Aruba (10 percent), Ecuador (8 percent), Panama (8 percent), United States (7 percent), and Venezuela (6 percent). In Colon, luxury goods destined for duty-free shops and other retailing operations tend to dominate economic activity within the zone.

Free zones targeting warehousing and distribution activities regularly offer management services to firms unable or unwilling to supervise their own operations within the zone. In Panama, there are a number of reputable management servicing companies while the Miami Foreign-Trade Zone offers full Distribution Management Services through the zone management. These management companies provide a wide range of services which include:

- 1) Pick and pack services.
- 2) Product packing, labeling, and marking for shipment.
- 3) Packing lists, invoices, and bills of lading.
- 4) Customs or other regulatory documentation needed.
- 5) Any other services required.

Another important aspect of the development of a commercial warehousing program is the provision of space for exhibition of stored goods. Many free zones, including Miami, Copenhagen, Helsinki, Vienna, and New York, serve the role of wholesale duty-free shopping centers. Buyers may inspect goods on display before purchase. The Miami Free Zone has become an important wholesale

center for Latin America as well as for retail duty-free shops and cruise lines operating in Latin America and the Caribbean.

Locational Requirements

In addition to an attractive and competitive investment incentives package, successful warehousing operations require good transportation facilities and infrastructure and competitive economic factors of production. Of paramount importance to their success is the need for a strategically attractive geographical location near major transportation hubs and service routes.

Successful transshipment operations require efficient port facilities and transportation services. It is important also that port facilities are capable of handling large amounts of traffic in a short time period. Administrative procedures must also reflect the need for a streamlined operation, and be short and uncomplicated. Specific economic and infrastructure requirements include:

Good Sea Port Facilities and Services. Most warehousing and distribution firms are dependent on effective sea freight services and facilities. A deep water, well-protected port with sufficient loading and unloading equipment. As break-bulk points, transshipment sites need to be able to accommodate ships of varying sizes, including large, long-distance bulk carriers. Cargo-handling facilities should be most efficient for both the site and the type of cargoes involved. In addition, port management plays a crucial role in effective cargo handling.

Good air freight services. In the past decade, the quality, frequency, accessibility, and reliability of air freight services has become increasingly more essential to the well-being of free zone commercial activity. This transformation is related to the fact that the primary products handled are high value-to-weight luxury goods. Panama is served by 36 passenger and cargo airlines and there are daily flights to Miami, New York, and Europe. Miami boasts of even better air service as it is one of the world's primary air transportation hubs.

Accessibility to major shipping routes. The world's foremost commercial free zones and transshipment centers are located at the crossroads of major shipping routes. The Colon Free Zone in Panama is situated directly on the Panama Canal while Hong Kong is located strategically between East Asia and Southeast Asia.

Efficient Port Workers. Unlike manufacturing operations that are highly dependent on large pools of inexpensive labor, commercial warehousing has only modest requirements for unskilled labor. The industry depends, however, on efficient port workers. If the stevedores in a transshipment center are slow, prone to strikes or pilferage, a commercial distribution firm would be unlikely to succeed in that location.

Inexpensive port fees. Efficient management and productive labor costs are directly proportional to port costs, which are normally

the determinant of fees. Most port authorities in smaller countries operate at a profit, taking advantage of what is normally a monopoly position, and charge high fees. To facilitate traffic, fees need to be competitive, and the management businesslike.

Excellent banking facilities. The financial needs of shippers and manufacturers necessitate the presence of sophisticated banking services for letters of credit, foreign exchange etc. The world's leading commercial free zones are not coincidentally found in locations with premier banking services. Panama, Hong Kong, and Miami are international financial centers. The Colon Free Zone itself is host to 24 offshore banks permitted to do business with zone firms.

Non-transportation infrastructure. Commercial free zones require reliable telecommunications, water, and electrical services. Excellent international telecommunications are particularly needed considering the global orientation of the zone tenants.

Annex A-5

EMERGING INFORMATICS SECTORS

Global Trends in Information Services Activities

There has been significant growth in the informatics industry during the 1980s for all of the major markets around the world. In 1987, the worldwide market for data processing, Computer-Aided Design (CAD), and software/computer services (encompassing most segments in the information services industry) reached US\$117 billion. The world's largest informatics market is the United States, with total expenditures of US\$53.5 billion in 1987. This is three times more than that of Japan, the next largest single country market, which had only US\$17.8 billion in user expenditures in 1987. The European Community recorded industry sales of \$US21 billion for the same year.

All of the developed country information industry markets are expected to grow at more than 20 percent per annum over the next three to four years. In the United States, the industry has expanded by more than 26 percent annually during the past eight years, twice as fast as GNP growth. Software development will prove to be a key sector in all developed country markets, with expected annual growth estimated at 25 percent.

The European Community is still lagging behind the US in both size and sustained growth of the information services industry. Beyond this, however, recent overall growth rates in the total information services industry have been almost significant as those in the United States. The EC information industry market is projected to grow at an average rate of 22 percent per year for the next five years.

Market Trends

Data Entry. Data entry consists of the conversion of text and/or numeric information on paper documents to digital form for storage or further processing. There are two types of data entry operations: slow turn-around (48 hours or more) and fast-turnaround (less than 48 hours). Most of the offshore data entry firms have been of the former category, relying upon air freight for shipment of source documents from their clients and also the return of magnetic tape and disks, which could take anywhere from three days to three weeks. Excellent and affordable international telecommunications line are a prerequisite for fast-turnaround data entry operations, as is a numerous work force trained to a high degree of accuracy and speed.

In the past five years, annual growth trends in the data entry market have stabilized and it is now considered to be the most mature segment of the information services market. Many public and private firms continue to contract for data entry services because they offer more choices and flexibility of hardware and software packages and, in some cases, at less cost than in-house facilities.

In the United States, user expenditures on data entry services rose an estimated 13 percent to US\$24 billion, after similar growth in 1986. Both private and public research organizations project annual growth rates for the data entry sector to remain at 12 to 15 percent annually until 1993, reaching an estimated value of US\$42 billion.

Facilities management and remote transaction processing, including such clerical operations as payroll, accounts receivable, and hospital processing services, accounted for the bulk of data entry expenditures. In the US, there is an estimated 2,121 data processing companies employing 297,000 workers. While the top four data processing companies each had revenues in excess of \$1 million in 1987, most firms in the industry earn annual revenues of less than \$10 million.

Data processing companies have been forced to adjust to the shrinking market which has accompanied the expanding use of microcomputers. In addition to adding new proprietary offerings, many data processors have expanded into other aspects of information services such as electronic mail, electronic data interchange, electronic database services, systems integration and software development. None of the top 20 companies derives all of its revenue from data entry services. Specialization has been the key for many firms. They have devoted services to one or more chosen applications, such as financial institutions or insurance, in order to develop an expertise in specific kinds of data processing. Nonetheless, the declining market share of the processing sector and the increased use of offshore bureaus has forced many firms to re-examine their production strategies.

The European Community is the second largest aggregate market for computer products and services. While only a small part of the entire computer products and services industry, data entry had generated an annual revenue of US\$5.3 billion in 1987. This figure is still only 22 percent of the US market. When comparing the population of the United States (245 million) with that of the EC (320 million), it is clear that Europeans are clearly behind the US in this industry. A contributing factor to this may be that while almost 75 percent of the databases in the US belong to the private sector, only 30 percent do so in Europe.

The largest markets in Europe (the United Kingdom, West Germany, France and Italy) account for approximately 65 percent of the total European computing services market. Processing services represent only 25 percent of the total European computer services market,

down from over 40 percent in 1978. As with the US, this small growth rate, compared with the rest of the industry, is due to the slow but steady decline in local batch processing activities.

Service bureaus in traditional data entry markets of North America and Europe face multiple pressures. Although narrow definitions of the data entry sector place employment at approximately 320,000 in the United States (with more liberal definitions yielding to an estimated 600,000 operators), it is clear that the sector is declining. In addition, the introduction of "point of Sale" transaction processing in the insurance and retail industries is reducing demand for the batching and inputting of paper documents.

Computer-Aided Design. CAD systems allow users to view, transform and store images, maps and other graphic data in digital form, thus greatly expediting other operations such as mechanical and electronics design, mapping, blueprinting, and construction and civil engineering. Therefore, valuable professional time is reduced for such repetitive tasks as composition and material selection, detail drawing and information retrieval. In the United States, there has been a proliferation of CAD systems which has created a huge demand for "digitizing" (the conversion of paper documents into computer-readable format). This requires an average of five hours per drawing. Operators and quality control procedures must be meticulous because these conversion operations require extreme accuracy. Thus, the quantity and quality of drafting skills of persons in the local workforce is a major factor in the success of such offshore service bureaus.

Computer-aided design systems, together with their accompanying demands for digitizing/vectorizing services, have created one of the fastest growing segments of the information services market. Utilities, municipalities, manufacturers, and various firms have turned to outside firms to digitize and vectorize copies of their nonsensitive archival maps and documents as the power of minicomputers and microcomputers and accompanying CAD systems has become apparent.

In 1987, expenditures on CAD services worldwide reached US\$9 billion, with rapid growth projected through the mid 1990s. The United States is the largest market for CAD services, with total expenditures reaching US\$3.5 billion in 1987. Both the US and other developed country markets continue to experience rapid growth rates, with substantial backlogs of paper documents awaiting conversion.

In 1987, Europe experienced CAD sales of US\$1.5 billion, which accounted for seven percent of the total computer services market in the EC. Growth is expected to remain consistent at 35 percent in the medium term. This same market will be worth US\$3 billion in 1990, followed by a more modest, yet still respectable rate of 20 percent. The potential for growth is evident in the Community, despite its relative lag behind the United States in applying technology to the industry.

The relatively affordable prices of microcomputer-based CAD systems (less than US\$8500 per work station plus US\$300 for a software package) has led to many new service bureau startups, typically with high levels of turnover and unstable quality control. The premium placed on accuracy by clients has led to the emergence of several large (300+ operators) two and three shift operations both onshore and offshore. Firms specializing in the conversion of documents into "geosystems", or geographic information systems (GIS) have recently emerged. These are digitized, multi-layered maps with extensive text and numeric databases regarding demographics, production factors, and market characteristics linked to appropriate features.

Software Development. In developed countries, an enormous demand has been created for software development, programming, customization and maintenance because of the proliferation of computers into almost every aspect of society. GTE, Cullinet, Wang and Westinghouse are just a few of the corporations and firms which use offshore programming service bureaus in such countries as Mexico, Costa Rica, Panama and the Dominican Republic. Because of improvements in telecommunications, long distance interactions are now possible between offshore programmers and their clients.

The European and North American software development markets have been growing by more than 20 percent annually in industry sales since 1980. In 1987, total worldwide revenues in the sector exceeded \$64.6 billion. Of the total software service market, worldwide customized software expenditures (as opposed to packaged software services) were US\$5.4 billion in 1986, US\$6.6 billion in 1987 and US\$8.1 billion in 1988. Computer consulting and training services accounted for nearly US\$8.4 billion in revenues, while integrated systems services earned US\$9.8 billion. These segments have grown 21 and 18 percent annually, respectively, from 1986 levels. The success of the software services industry, however, has been accompanied by a steady rise in developed country labor costs. The average salaries paid to US programmers, for example, stand at over US\$28,000, with systems analysts making over US\$33,000.

North American firms have been very successful with sales of software services, generating US\$26 billion in revenues. With the decline of the US dollar, international sales of US software have increased and now contribute 40 percent of the annual sales of packaged software producers worldwide. Accordingly, there is a high demand for systems analysts, programmers and technical writers with foreign language skills in US computer services firms.

As in the North American market, European independent software development firms and professional services firms no longer have unchallenged leadership in the software services sector. Computer hardware manufacturers have hired increasing numbers of in-house software specialists to deal with challenges of developing new operating systems and value-added features for targeted markets. There has been a trend toward industry concentration, particularly

as a result of mergers and acquisitions by large data processing companies and their smaller competitors.

Overall, the EC software and computer services market has grown to US\$14.1 billion in 1987. Growth rates for the industry segment have averaged 20 percent in 1986 and 1987. In France, revenues totalled US\$3.4 billion, with the United Kingdom and West Germany revenues placed at US\$3 billion.

Growth in the software and computer services segment will be driven by several factors in both the European Community and United States: a shortage of trained personnel in developed market countries; evidenced backlogs for software application development (software costs now exceed hardware costs); increased importance of maintenance services relative to development services; and the increased complexity of software applications (the average length of software programs is growing 25 percent annually).

Other Developing Sectors

In addition to the afore-mentioned already established informatics activities, alternate provision of low-cost international telecommunications services has provided new opportunities, as outlined below.

Voice Center Operations. Voice centers involve human handling of incoming or outgoing telephone calls. Within the United States, as well as other developed countries, the number of telephone operators in reservation centers, order fulfillment centers and answering services now exceeds 400,000, with the volume of toll-free calls growing at rates at more than 15 percent per annum. On an average, operators in the United States are now earning US\$8.00/hour. Although the vast majority of the public prefers communicating with a human operator, the costs of maintaining voice operating centers has prompted corporate clients to introduce digitized voice answering, routing and message systems. In ensuing years, airlines, hotels, mail order distributors and related firms are expected to utilize the English and Spanish capabilities of countries in Latin America, especially to serve the growing number of Hispanics in the United States. The labor-intensive nature of many telephone operator services creates opportunities for offshore locations with favorable labor costs. However, the feasibility of such voice center operations rests upon the prices charged for dedicated two-way international voice/data lines; monthly costs in excess of US\$1000 per international line rapidly offset any labor savings from an offshore location. In addition, success in these types of operations is proportional to the successful promotion of excellent English and Spanish language skills in the workforce.

Remote Secretarial Services. Shortages of secretaries with multiple office skills have led to growing interest by businesses in using off-site contractors. More than six million secretaries are now employed by American firms at an average salary of US\$15,000. The demand for qualified secretarial workers in the United States continues to grow more acute, leading to increasing reliance upon firms which are now evaluating offshore location options. Assuming affordable telecommunications links with the main office, a few functions such remote secretaries can provide are word processing of handwritten reports and correspondence, telephone message-taking services, and transcription of dictated memos and letters.

Graphic Arts Services. Desktop publishing, including computer-based layout and design, illustration/animation and other media related services, is also a high growth-potential market segment. In Europe and North America, there are millions of microcomputers with desktop publishing capabilities. Commercial art services have begun to offer packaged desktop publishing, clip art and customized graphics support.

Translation Services. Language translation services are a major offshore informatics growth activity. In the next five years, the US market for the translation of technical and commercial materials will approach US\$100 million. The costs of such translations range from US\$15-50 per page. As companies attempt to sell products to non-English speaking markets, demand is increasing for translated commercial documents such as business cards, product literature and technical documents. The most frequently targeted language is Spanish, followed by French and German. Although there has been considerable research on machine translation, document translation will remain a highly labor-intensive activity for the foreseeable future. Accurate document translation, especially of technical documents, requires persons with strong multilingual abilities, in addition to graduate degrees.

ANNEX B

OPERATIONAL ZONES

Annex B-1

PROFILE OF OPERATIONAL ZONE: COLONIA

1. Contact Information

Name of Zone: Colonia
Address: Colonia
Phone: 0522243
Telex/Facsimile: 329010

2. Ownership

Name of Zone Owner/Management Organization: Ministry of
Economy and Finance
Status: Government

3. Development History

Year Designated : 6/20/23
Year Operational: 1923

4. Profile of Current Activity at Zone

Number of Firms in Operation: 19 direct, 2 indirect
Industry Mix (% of Zone Firms by Sector):

Commercial (Warehousing): 92%
Food: 0%
Pharmaceuticals: 4%
Other: 4%

5. Site and Facilities

Area of Improved Land (HA): 10 of 100 hectares total; new
area under work 10 hectares for 1990.
Space Under Roof (now occupied): 11341 square meters
Space Under Roof for Immediate Lease/Sale: none
Type of Buildings: sheds with lightweight sheet metal siding
Average Size of Buildings: 520 square meters

6. Rates

Policy Regarding Lease Versus Sale: lease of unimproved land
Standard Lease Rates: US\$5/square meter approximately
Lease Contract Duration: 5 yrs. commercial; 20 yrs.
industrial
Required Deposits and Other Basic Contract Conditions:
deposit of 50 percent of annual payment until obtaining the
classification of user.

7. Labor

Basic Hourly Rate \$US: 1.00

Hourly Rate with Mandatory Fringe Benefits: 1.17

8. General Infrastructure

Nearest International Airport: Carrasco -- 220 km

Nearest Port: Colonia -- 300 m

Proximity to Highways: 1 km

Water: potable from public network

Other: electric power

9. Freight Services

*Cost of Scheduled Air Freight to New York: up to 167 kg/
cubic meter equivalent to 1 ton -- US\$2,100*

*Cost of Scheduled Ocean Freight to New York: 1 container of
10 tons up to 30 cubic meters -- US\$3,100*

10 Raw Materials/Intermediate Goods

*Local Agricultural Products suitable for Export Processing:
meat, milk, leather, wool, fruit and vegetables, wheats,
sugar, rice spices, poultry, honey, corn, soya, fish.*

*Local Mineral Resources Suitable for Export Processing:
agate, amethysts, marble, granite, flagstone, limestone,
manganese*

Annex B-2

PROFILE OF OPERATIONAL ZONE: NUEVA PALMIRA

1. Contact Information

Name of Zone: Nueva Palmira
Address: Nueva Palmira -- Dpto. de Colonia, Uruguay
Phone: 229 or 227
Telex/Facsimile: 29003

2. Ownership

Name of Zone Owner/Management Organization: Ministry of
Economy and Finance
Status: Government

3. Development History

Year Designated : 6/20/23
Year Operational: 1923

4. Profile of Current Activity at Zone

Number of Firms in Operation: 6; 2 to sign
Industry Mix (% of Zone Firms by Sector):

Commercial (Warehousing): 64%
Food: 12%
Pharmaceuticals: 12%
Automobile Assembly: 12%

5. Site and Facilities

Area of Improved Land (HA): 22
Space Under Roof (now occupied): 4,586 square meters
Space Under Roof for Immediate Lease/Sale: none
Type of Buildings: sheds with lightweight sheet metal siding
Average Size of Buildings: 750 square meters

6. Rates

Policy Regarding Lease Versus Sale: lease of unimproved land
Standard Lease Rates: US\$5/square meter approximately
Lease Contract Duration: 5 yrs. commercial; 20 yrs.
industrial
Required Deposits and Other Basic Contract Conditions:
deposit of 50 percent of annual payment until obtaining the
classification of user.

7. Labor

Basic Hourly Rate \$US: 1.00

Hourly Rate with Mandatory Fringe Benefits: 1.17

8. General Infrastructure

Nearest International Airport: Carrasco -- 277 km

Nearest Port: Nueva Palmira -- 1 km

Proximity to Highways: 2 km

Water: by means of drilling

Other: electric power

9. Freight Services

*Cost of Scheduled Air Freight to New York: up to 167 km/
cubic meters equivalent to 1 ton -- US\$2,100*

*Cost of Scheduled Ocean Freight to New York: 1 container of
10 tons up to 30 cubic meters -- US\$3,100*

10 Raw Materials/Intermediate Goods

*Local Agricultural Products suitable for Export Processing:
Agriculture/cattle*

*Local Mineral Resources Suitable for Export Processing:
marble, granite, agate, onyx, quartz and limestone*

ANNEX C

POTENTIAL GROWTH POLES

Annex C-1

GROWTH POLE: MONTEVIDEO

The capital of Uruguay, Montevideo is the country's economic and political center. It can be estimated that fully 50 percent of the nation's GDP is generated in Montevideo. More than 42 percent of the Uruguayan citizenry lives in Montevideo and it is the center for both industry and services. More than 64 percent of the industrial enterprises in Uruguay are located in the capital city. The port of Montevideo is the passageway for the near totality of the country's imports and exports and has contributed to the development of a dynamic commercial sector in the city.

With 1,252,000 inhabitants, of which 585,000 are economically active, Montevideo is the major employment center for the country as well. Twenty-five percent of its residents are employed in the manufacturing industry, 17 percent in commerce, and nearly 50 percent in the full range of service activities (banking, finance, telecommunications, transport, etc.). The unemployment rate is 8.9 percent, representing more than 50,000 persons. Wages are higher than the government mandated minimum, but comparable to elsewhere in the country ranging from US\$1.13/hour (unburdened) for a trained sewing machine operator, to US\$5.19/hour (unburdened) for a production foreman. Labor disputes are more frequent than elsewhere in the country and often occur when the Government is amending the minimum wage regulations.

Overall, the availability of raw materials and intermediate goods is greater in the Montevideo area than in virtually any other part of the country. As the industrial center of an agriculture-based national economy, it is primarily specialized in the transformation of agricultural commodities. Particularly important are the manufacturing of textiles and clothing, leather, rice, dairy products, citrus, and barley. The city is also developing industries oriented towards the transformation of chemical, synthetic and cotton textiles, ceramics and auto parts.

Installed infrastructure in Montevideo is the best in the country, and there are few problems with the quality and reliability of basic service delivery. Business support services are well developed, financial, clerical, insurance, repair and supplies. Quality of life and local living standards are generally high. There is an abundance of housing for sale or rent, hospitals, universities, private primary and secondary schools, etc. Bilingual educational programs are available for foreign students. Cultural and recreational amenities are well established.

Annex C-2

GROWTH POLE: FRAY BENTOS

Fray Bentos is the capital of the Rio Negro district, a Uruguayan region with an area of 9,262 km. Although Fray Bentos is relatively undeveloped at present, its location and infrastructure make it a suitable development pole. Local economic activity is presently dominated by the agricultural sector, specifically the cattle industry, and to a lesser extent commercial and service activity. There are virtually no industrial operations. Businesses based in Fray Bentos account for less than 1 percent of the total Uruguayan business community.

Fray Bentos is located proximate to the San Martin bridge, linking Uruguay to Argentina, with a well-developed port with a natural draft of 21 feet and a capacity to handle vessels of up to 18,000 tons. The port is adjacent to a national railroad line, although there is no rail service at present.

The port is under-utilized with limited use as an export point for soy beans and an import location for barley used in processing at a Uruguayan brewery. This level of trading activity could be augmented if the port were used to channel exports from Argentina and Paraguay. The international bridge acts as an import port of entry for Argentine tourist traffic, accounting for more than 21 percent of the 1987 entries to Uruguay. Likewise, the bridge is heavily used for trucking as a passageway between Argentina and Paraguay and Brazil. In general, little effort has been made to capitalize on these locational advantages and economic activity has been minimal. The closest international airport is in Montevideo. Electricity provision is adequate and potable water is available from the Uruguay river. Telex, telephone, and fax service is available.

The population of Fray Bentos is 20,135 of which 12,006 are more than 20 years old. The economically active population of the district is an estimated 17,730 persons. The Government of Uruguay sets a minimum monthly salary level and daily wage rate every three months, presently US\$80/month or US\$3.20/day for wage labor. In the Fray Bentos region, due to the low level of economic activity, prevailing wages are lower than the national average, although higher than the Government minimum, estimated at US\$1/hour, rising to US\$1.17 with the inclusion of fringe benefits. Unskilled labor is plentiful in the district, although the lack of job opportunities has resulted in significant out-migration. Consequently, the unemployment level is a comparatively low 6-7 percent.

The quality of life in the Fray Bentos region is acceptable, although there is little in the way of amenities and quality housing. While public primary and secondary education is available, the nearest university is 228 kms. (Salto) or in Montevideo, 300 kms to the southeast.

Annex C-3

GROWTH POLE: LA PALOMA/ROCHA

La Paloma is the most important beach resort in the Rocha district and is located 240 kms from Montevideo on the Atlantic coast, linked to the district capital of Rocha by a 30 km highway. The economy is dominated by service activity linked to the local tourism and fishing industries which have been growing in recent years.

In terms of the tourism sector, domestic tourism predominates. For foreign visitors, La Paloma is also the most important of the oceanic beaches of Uruguay. The average length of stay of tourists to the ocean beaches is 18 days. An estimated 7,250 foreign tourists visited La Paloma in 1988, of which nearly half stayed in local campgrounds, only 785 stayed in hotels, and the remainder was housed in private homes. Reflecting this distribution, there are only 15 hotels in La Paloma, of which three are "Class A."

There are five local fishing businesses, most of which handle the full range of activities from fishing to freezing of seafood. The industry's growth has been supported by a rich resource base. While the fishing sector has become an important employment generator for the district, measures could be undertaken to improve the yields and processing methods. Due to the higher cost of living in La Paloma, many workers are transported by bus from La Rocha.

Land suitable for industrial development (more than 10 hectares) with access to basic services is available in the La Paloma area. There are no problems in the delivery of electricity, water, and sewage services. Neither railroad nor airport services are offered, the nearest international airport is in Montevideo. Trucking service is available from Montevideo to La Paloma at an estimated US\$17/ton. Banking and financial services are offered locally, however repair services for machinery are non-existent and must be obtained in La Rocha. Telephone service is available.

The prevailing wages in La Paloma are relatively the same as those in Montevideo and elsewhere in the country. In the fishing industry, for example, a basic laborer would receive US\$1.05/hour, a plant foreman US\$5.20/hour, and a machine operator US\$1.60/hour. Social charges add an estimated 17-23 percent to unburdened wages. As mentioned above, most of the workers employed in La Paloma actually reside in La Rocha, which has a population of 24,015 persons.

Public primary and secondary education is available in La Paloma. The nearest technical training center is the University of Labor located in La Rocha, or in Montevideo for a general university education. Overall, the quality of life in La Paloma is excellent. High-quality housing, private medical service, and recreational facilities are all well established.

Annex C-4

GROWTH POLE: RIO BRANCO

Located in the northeast region of the country, 400 kms from Montevideo, Rio Branco is on the border with Brazil near the Brazilian city of Yaguaron. The city has a strong economic dynamism brought on by the proximity to Brazil and the (legal and illegal) commercial trade with that country. It is the second most important overland port of entry for Uruguay, accounting for over 25 percent of total trucked imports and exports.

In addition to the thriving commercial sector, a local rice milling industry for export has been developed, taking advantage of the excellent local conditions for its cultivation. The Cerro Largo district where Rio Bravo is located is characterized by ranching (cattle and sheep) and production of meat, wool and dairy products, both for national consumption and for export. Horticulture and fruit production is also based in the area. Gypsum deposits are also located close to the city.

Drawn by employment opportunities in these industries, Rio Branco is already attracting new residents. Since 1975, the local population has grown at an annual rate of 4.8 percent, nearly ten times greater than the national average. With a population of 5,600 persons older than 20 years, commercial and service activities account for roughly 63 percent of total employment. Rio Bravo has a sizeable pool of labor from which to draw, consequently salaries are somewhat lower than the national average at US\$1.00/hour.

Housing is scarce, as are business support services such as machinery repair, clerical services, recreational facilities, and private medical facilities.

Annex C-5

GROWTH POLE: BELLA UNION

Located in the northwest corner of Uruguay, 630 kms. from Montevideo, the city of Bella Union is found in a rich agricultural area, bounded on the north by the Cuareim river and to the west by the Uruguay river. The subtropical climate, with mild temperatures and heavy annual rainfall is ideal for cultivation and has been the stimulus to the city's economic growth.

The primary agricultural activity has been sugar cane cultivation using high-technology production methods and advanced irrigation systems. Within the region, a sophisticated agro-industrial complex has developed comprising over 8,000 hectares of land and 400 individual producers, joined together in a cooperative to process and sell their crops. The success of this approach can be measured by the fact that the production of cane rose from 9,350 tons in 1965-66 to 66,000 tons in 1986-87, from 8 percent to 53 percent of total national production of sugar cane.

The second most prominent agricultural activity is the production of fruits and vegetable, such as, tomatoes, peppers, and strawberries. Because of the climatic conditions in the region, these crops are harvested and brought to market in Montevideo earlier in the season than those cultivated in the south. As in the sugar cane industry, crop yields and quality have been improved by the advanced technology employed in their cultivation.

A third area of importance is the growing grape industry, producing not only grapes for raw consumption but fine wines for the domestic and international market.

In the Bella Union region, the public and private sectors have joined together to launch a Regional Development Plan to contribute to the development of agriculture, industry and services in the region. Cooperative efforts include the construction of a refrigeration plant for horticultural products, improved irrigation infrastructure, incorporation of new machinery and lands in production, rural electrification, etc.

With 17,650 inhabitants, the Bella Union area has experienced a rapid population growth of 4 percent per annum -- eight times the national rate -- reflecting its economic dynamism. The opportunities for employment have drawn workers not only from the Artigas district, but from other regions of the country. Wages are generally reflect the government established guidelines of US\$80/month and US\$3.20/day as minimum wages with the exception of the sugar cane industry. The area sugar cane cooperative pays wage that are substantially higher than in other rural areas of the country--US\$200/month, rising to US\$400 during the harvesting

season. Substantial labor is consequently drawn to the region.

Infrastructure and services are in need of improvement. Potable water is a problem as is sewage treatment, although initiatives are underway to ameliorate these shortcomings. While urban electricity provision is adequate, rural electricity needs upgrading. The rapid population growth has resulted in a shortfall in adequate housing and basic service delivery throughout the city as well, only 50 percent of the city is serviced by the water distribution system, 14 percent by the sewage system. The quality of life offered is generally acceptable, although improvements are needed in cultural amenities, and the education system is entirely public.

There are no port facilities for water or air cargo. The closest river port is Fray Bentos, 300 kms to the south. Trucking freight rates to Montevideo are high at US\$40/ton, however railroad cargo can be transported to Montevideo for US\$23 for volumes of ten tons and up.

Annex C-6

GROWTH POLE: PUNTA DEL ESTE/MALDONADO

Punta del Este is the most important beach in the country, located 140 kms to the east of Montevideo. The economy of Punta del Este is closely linked to that of the district capital of Maldonado, located slightly inland. Punta del Este is internationally recognized for its beaches and recreational facilities and consequently, tourism is the most important economic activity for both cities. Maldonado is the residence for most of Punta del Este's work force related to the tourism industry. Beef processing industries are also established.

The majority of the business establishments in the area are related to tourism. Of the 1,0046,940 visitors to Uruguay in 1987, nearly one third went to Punta del Este. Most of these visitors are from within the region, primarily Argentina. Consequently, the economic health of neighboring countries has a direct impact on the economy of Punta de Este, and the tourism sector of Uruguay as a whole. It is also important to note that nearly 40 percent of the tourists, again largely Argentines, own their own homes in Punta del Este, representing a "captive" market. This trend has supported a sizeable construction business of quality homes in the area. On average, over the last five years Punta del Este has accounted for 73 percent of the tourism income of the country.

There are 69 hotels in the area, 17 of which are categorized as "first class" by the Ministry of Tourism. An estimated 25 percent of the tourists visiting the beach area rent private homes. The average stay is 23 days.

Maldonado has a population of 33,536 persons, Punta del Este, 6731. Approximately 25,000 of this total are economically active. For the district as a whole, the predominance of tourism is shown by the sectoral employment breakdown: 35 percent in services; 15 percent in sales, restaurants and hotels; 14 percent in construction; and 36 percent in all other sectors (farming, industry, etc.).

Wage rates are higher than the national average due to the higher cost of living in the region and the seasonal nature of the tourist industry. During the summer season, the area draws workers from other parts of the country in search of employment.

Typical hourly wages (unburdened) are presented in the table on the following page:

Labor Costs (Punta del Este/Maldonado)

Construction:

Day laborer	US\$1.35
Master bricklayer	US\$1.97
Foreman	US\$4.78

Hotels:

Maid	US\$1.30
Manager	US\$8.10

Restaurants:

Waiter	US\$1.85
Chef	US\$5.36

As is the case elsewhere in the country, mandatory fringes add an estimated 17 percent to the cost of salaries.

In terms of infrastructure and services, there are no problems with electricity transmission and quality, nor in potable water provision. Punta del Este has a port that is used primarily for recreation purposes. There is also an international airport servicing flights from Argentina and a domestic airport. Montevideo, 140 kms away, is the closest international airport for flight outside the region. The highway connecting Punta del Este with Montevideo is one of the best roadways in the country. Overland transport costs for trucking from Montevideo are an average of US\$11/ton.

Banking and financial services are well established, but most other types of business support services are in short supply. Private primary and secondary schools are also available for expatriates.

As the surrounding area is known for ranching, there is a substantial supply of beef, dairy products, and to a lesser extent, wool. Minerals such as granite, marble, and lime are also locally available.

ANNEX D

EMERGING ZONE INITIATIVES

Appendix D-1

PROFILE OF POTENTIAL MONTEVIDEO ZONE (FOR SERVICES/INFORMATICS)

1. Name of project: The Services Free Zone
2. Date Initiated: 1988
3. Characteristics of Site: Urban
 - Size and Dimensions.* 800 square meters
 - Present Owner.* Private Ownership -- SAFEMA/Estudio Luis E. Lecueder
 - Present Land Use.* raw land.
 - Proximity to International Airport/Port.* 16 kms to the nearest airport; 1 km to the nearest port.
 - Topography/Drainage Characteristics.* There are existing drainage facilities.
 - Extent of Existing Site Improvements/Building Construction.*
Infrastructure: The site is accessible to all the basic services, such as telecommunications, electricity, sewage, etc. due to its urban location.
 - Special Site Attributes and/or Problems.*
Attributes: The Services Free Zone is located in the middle of the Montevideo financial district.
4. Nature of Partnership Sought with Foreign Partner: This relationship has not been defined, but is currently under study. Formal contacts have been made with the World Trade Center to evaluate the viability of a similar setup in terms of service provision.
5. Background on Uruguayan Zone Development Partner(s):
 - Name of Company:* Estudio Lecueder
 - Primary Products/Services:* The development and administration of investments; also, construction of housing and shopping centers.
 - Date Founded:* 1972
 - Experience with Free Zones and/or Property Development:* Examples of typical real estate projects undertaken by the company are as follows: Montevideo Shopping Center, 58 buildings of Propiedad Horizontal (approximately 2000 housing units) for a sum of approximately US\$100 million.
6. Indicators of Market Demand for Project: No special study has been done, although similar projects have been successful in other Latin American countries.

7. Unilateral Actions Being Taken/Planned by Uruguayan Developer:
The possibility of undertaking a feasibility study for the ZFS is being looked into.

8. Near -Term Actions Desired From Potential Foreign Counterpart:
A preliminary study of potential demand and the determination of a possible framework for cooperation.

9. Key Contact Person, Address, and Phone for Project:
Please address inquiries to Cr. Carlos Alberto Lecueder at either of the following addresses:

Convencion 1343 P.9 Montevideo
Uruguay
Tel. 92.13.33 (Montevideo)

or
Lavalle 1118 P.4/H Buenos Aires
Argentina
Tel. 35.82.80 (Buenos Aires)

Appendix D-2

PROFILE OF POTENTIAL MONTEVIDEO ZONE (INDUSTRIAL/COMMERCIAL)

1. Name of project: Montevideo Zona Franca
2. Date Initiated: The start date will depend on various factors, including the development of the project, and the response of the Executive Power of the Uruguayan Government to the request for zone designation prior to September 30, 1989. We have an interest in initiating work before November 30, 1989.

3. Characteristics of Site: Urban

Size and Dimensions. 40 Hectares, measuring 425 x 941 meters

Present Owner. Jackson Agricultural School, Sociedad de San Francisco de Sales

Present Land Use. The Agricultural School utilizes a portion of the site, with the remainder occupied by an orchard.

Proximity to International Airport/Port. The site is located at kilometer 17.5 on Route 8, at the junction with Route 102, in the Department of Montevideo. The distance to the International Airport is approximately 10 kms.; the distance to the port is about 20 kms.

Topography/Drainage Characteristics. Because of the slightly undulating nature of the topography, excellent natural drainage exists for the site.

Extent of Existing Site Improvements/Building Construction.
Infrastructure: The parcel envisaged does not presently have existing site improvements, although a free zone could be easily developed on the location.

Special Site Attributes and/or Problems.

Attributes: The location of the site at the intersection of Route 8 and Route 102 permits rapid access to the airport and the port. Also, utilities such as electricity, telephones, and water are readily available. The excellent transportation access enables workers to commute readily to the site from Montevideo and from Pando.

However, the availability of these services is being analyzed with UTE; similarly, the availability and costs of energy and water are now being examined. There exists a possibility of access to sanitary facilities, although at a high cost. Therefore, we expect to restrict the types of projects that will be undertaken at this location.

Montevideo represents a true growth pole for attracting development in industrial and commercial sectors, since all the infrastructure and services necessary are available for efficient utilization.

4. Nature of Partnership Sought with Foreign Partner: In principle, we consider that the project can readily be developed with Uruguayan capital. However, this is not yet a rigid policy, given that the project is at a preliminary stage and we have not mobilized all of the capital investment commitments necessary. In the event that foreign capital investments were included, we would consider as partners commercial or industrial tenants in the free zone, or firms who have experience in the construction and operations of free zones at an international level.

5. Background on Uruguayan Zone Development Partner(s):
Name of Company: Costa Oriental S.A.
Primary Products/Services: Services in free zones and in international business advisors
Date Founded: 1984
Annual Sales: US\$600,000
Experience with Free Zones and/or Property Development: Activities of the company have been underway in the Colonia Free Zone for the past five years.

For the present, we are keeping confidential the identity of some of the Uruguayan partners. However, they too have substantial free zone experience.

6. Indicators of Market Demand for Project: Our understanding of the market has been formed through our experience in Colonia and the difficulties encountered there by the lack of adequate infrastructure. Permanent contacts with the Argentine and Brazilian business communities enable us to conclude that many of the planned business ventures have a concrete interest in establishing operations in a free zone in the Montevideo area.

7. Unilateral Actions Being Taken/Planned by Uruguayan Developer: To date, we have taken the following steps on behalf of the project:

- we have taken an option to purchase 40 hectares of the land described above;
- we have entered negotiations with UTE, the supplier of electrical energy;
- we have information from OSE regarding the availability of water and related services for the site;
- we have been in contact with ANTEL (the telephone service provider) regarding the present availability of telephone and telex service;
- we have contacted three foreign consultants, and will select one with whom to collaborate in the project;
- we have held meetings with policy leaders, the Ministry

- of Economy, and the Director of Free Zones to inform them and learn of their opinion about the project;
- we have organized a trip to visit leading free zones of the Far East.

In all of these instances, we have been satisfied by the response.

8. Near -Term Actions Desired From Potential Foreign Counterpart:
We would be interested in contacts with parties that have the understanding and know-how for successful free zone development, as well as the possibility of developing industrial and commercial projects.

9. Key Contact Person, Address, and Phone for Project:
Please address inquiries to:

Cr. Orlando Dovat
Dovat, Carrquiry & Asociados
Sarandi 693, p. 3
Montevideo,
URUGUAY
Tel.: 5982 961 790 or 961 697
Telex: DOVAT UY 22079
Fax: 5982 961 822

Appendix D-3

PROFILE OF POTENTIAL FRAY BENTOS ZONE

1. Name of project: Fray Bentos Industrial Park
2. Date Initiated: December, 1987
3. Characteristics of Site:

Size and Dimensions. Land for ex add-storage plant measures approximately 200H.

Present Owner. The State, through the Ministry of Agriculture and Mariculture.

Present Land Use. Export recycling factory -- 25H; American subdivision under jurisdiction of the Mortgage Bank of Uruguay -- 25H; Parking (golf course) -- 25H; Rural land -- 125 H.

Proximity to International Airport/Port.

Carrasco Airport, Montevideo -- 310 km
Alternative Airport, Durazno -- 200 km
Ezeiza Airport, Buenos Aires -- 300 km
Airpark, Buenos Aires -- 280 km
Gualeguaychu Airport, Entre Rios -- 60 km
Paysandu Airport -- 120 km
Mercedes Airport -- 35 km
Fray Bentos Landing Strip -- 5 km
Fray Bentos Overseas Port -- 2 km
American Overseas Port -- same lot
Montevideo Port -- 310 km
Buenos Aires Port -- 280 km

Topography/Drainage Characteristics. Natural Drainage following topography. Land above river level represents no problem

Extent of Existing Site Improvements/Building Construction.

Infrastructure:

- excellent water sources for industrial and drinkable use
- own energy source (motors and boilers);
- VTE power line at site; VTE 30,000 kw transformer within 5 km, VTE 150,000 kw transformer within 30 km
- elimination of water wastes
- good roadways for light weight and heavy shipments
- national railroad could be linked with a 7 km track extension

Extent of Existing Site Improvements (continued)

Buildings:

The constructed area (approximately 50,000 square meters) is in good, average and poor condition (sheds, cold storage, loading dock, cisterns (4,200 cubic meters), water services from the river, roadways)

Special Site Attributes and/or Problems.

Attributes

- center of regional services which include the river basin, railway and roadways

Problems

- shortage of equipment

4. Nature of Partnership Sought with Foreign Partner: open
5. Background on Uruguayan Zone Development Partner(s):
no development partnership exists at present
6. Indicators of Market Demand for Project:
Domestic Indicators. Demand in Uruguay has decreased greatly; only exporters and importers with intentions to participate in the regional market are interested.
Foreign Indicators. there is demand in Argentina, Paraguay, Brazil, Bolivia, America, Japan, Italy, and England. The IMRN has received missions from the following industrial firms interested in the free zone:
Kambara Uruguay Y Asociados -- Japan -- poultry packing plant
Valiert S.A. -- England -- textile plant
Adak S.A. -- Argentina -- auto assembly
Cortan S.A. -- Italy -- leather goods
Proyemar S.R.L. -- Argentina -- shipyard
Anglo S.A. -- Argentina -- [citrus juice concentrate]
Asesora Industrial S.A. -- Argentina -- tractor assembly
Commercial Del Sur S.A. -- Argentina -- [cotton] mill
Poliestar S.A. -- Argentina -- mattress factory
Carcomar S.A. -- Argentina/Uruguay -- fish processing (from river)
Agroalcol S.A. -- Argentina -- alcohol production without sorghum
Consorcio Brasileiro -- Brazil -- pine resin
Transparaguay S.A. -- Paraguay -- grainery
Madex S.A. -- Uruguay -- timber exports
7. Unilateral Actions Being Taken/Planned by Uruguayan Developer:
Except for the initial contract, we don't know about the actions taken by the Uruguay developer .
8. Near -Term Actions Desired From Potential Foreign Counterpart:
If the Uruguayan developers do not request to be direct participants in the Fray Bentos free zone, the foreign firms will be encouraged to negotiate the first phase proposed (renovating the factory) as direct user for 1 IMRN.

9. Key Contact Person, Address, and Phone for Project:
Please address inquiries to either:

Sr. Arq. Cesar Nogueira
(Director of Planning for Fray Bentos Free Zone) or
Sr. Artigas Pereira Rohner
(Secretary Coordinator of the IMRN)
18 de Julio 1275 Esc. 504
Montevideo ROU.
Tel.: 5982 90.24.66

ANNEX E

**STRUCTURING ZONE
DEVELOPMENT VENTURES**

Annex E

STRUCTURING FREE ZONE DEVELOPMENT PARTNERSHIPS

Private and public sector zone development organizations in Uruguay have a number of options concerning the creation of partnerships for zone financing and development. The following are types of relationships that have been successfully applied in other countries, and which may prove useful in structuring the potential privatization of existing public sector zones, or in the formation of business partnerships for new zones in the country.

Basic Approaches

Shared Equity Development. A basic option for undertaking zone development venture is the shared equity relationship, in which local private sector and foreign participants put resources at risk and take corresponding equity shareholdings in the development. An example of an active foreign investor-led development, initiated in 1959, is Freeport, Grand Bahamas. A North American private investment group, in partnership with local Bahamian institutions, formed a for-profit joint venture that has since built an industrial park, installed private water and power generation systems, developed an international port and airport, and constructed extensive resort and residential facilities. Within the Dominican Republic, the San Cristobal Free Zone stands as a different example of a shared equity development. In this case, the active developer is a Dominican entrepreneur, with passive investment from a multinational corporation (GTE). In the case of the African free zone initiative, a local partner could be expected to take a shareholding interest in a joint venture zone development company in proportion to the value of the real estate, building materials, construction services, and/or local currency investments committed.

Build-Operate-Transfer Agreements. Another approach consists of a Build-Operate-Transfer arrangement between foreign and local partners. In 1969, such an agreement was adopted by Gulf + Western as a condition of Government authorization of the first free zone in the Dominican Republic. In Turkey, the Bechtel construction company has negotiated the framework of an agreement for a \$220 million private free zone/port development project at Yumurtalik, which allows the private financial consortium to recover its investment by being granted operating rights for a defined period. At the end of this period, the ownership of the zone will be transferred to local authorities. The prospect of inheriting a thriving free zone, ten to twenty years after its activation, is unusually appealing to local partners.

Land Lease to Developers. The world's leading free trade zone--the freeport of Hong Kong--has been built almost entirely by private developers who purchased long-term land leases from the Government. As a means of mobilizing new private sector resources and introducing aggressive management and promotion, public and/or

private zone developers in Uruguay may wish to explore a similar policy of leasing all or part of their sites to overseas development organizations. These foreign developers can assume responsibility for subsequent site improvements and building construction. Given the recent political turbulence in China, it may be singularly propitious time to announce the willingness of Uruguayan free zone developers to enter into such relationships with Hong Kong development companies. One such Far East property development consortium has recently approached a public sector free zone in Honduras for lease of a portion of its land, to construct six buildings for Asian firms.

Other Forms of Relationship. The following are other types of relationships that the zone development consortium might undertake in association with local counterparts:

Private Utilities Provision. Recognizing the need to upgrade infrastructure within and near free zones, nations are increasingly encouraging the private provision of telecommunications and power generation services in association with free zones. Privately-financed satellite earth stations are now appearing in the Dominican Republic, Mexico, India and Jamaica to service firms based in free zones and industrial parks. Similarly, proposals for commercial electric power generating systems are now being solicited by several private Dominican free zones.

Association Responsibilities. Zone developers have the option of building into their property lease or sale agreements the requirement that occupants share responsibilities for certain types of basic service provision. These contractual agreements may obligate occupants to set a monthly or annual self-assessment fee (along the lines of a condominium association fee) to support such services or amenities as groundskeeping, refuse collection, shared food canteen or worker health facilities, and recreational areas.

Subcontractor/Shelter Plan Affiliations. Zone developers in countries such as Mexico, Haiti and Costa Rica have found substantial benefits in making alliances with subcontracting enterprises or in establishing shelter programs. Such operations, whether partly or wholly-owned by the zone development group, can grow through referrals of business from the zone marketing/promotion team. Zone promoters find many firms that are more interested in sending work to an affiliated operation than in becoming a direct zone tenant.

Training Linkages. In a growing number of countries, free zone developers are building relationships with training institutions to ensure the availability of needed technical skills for their tenants. Approaches to highly-regarded training institutions can lead to tailoring of curricula to meet zone user needs and development of work/study programs to give students on the job experience.

Contract Services. A further category of free zone development relationships is that of a "fee-for-service" agreement between the zone developer and the affiliated firm. Typically, virtually all zones enter into such relationships at some point in their planning, implementation, or operations. After securing needed capital, for example, the zone development consortium will be in a position to engage local firms to prepare the site and construct buildings, to provide regional marketing and promotion services; and possibly to provide certain property management services directly. In the latter cases, it will be advisable to negotiate performance-linked compensation agreements, offering incentives in proportion to the amount of free zone space leased or purchased by zone tenants.