

PN-ABL-084

Best available copy -- page 26 missing

PROSPECTS FOR FREE ZONE DEVELOPMENT IN BELIZE

Final Report

September 26, 1986

Free Zone Authority/The Services Group
1515 N. Lynn Street, Suite 200
Arlington, Virginia 22209 USA
Telephone: (703) 528-7444
Telex: 292072 FZAS UR



PROSPECTS FOR FREE ZONE DEVELOPMENT IN BELIZE

	<u>Page</u>
LIST OF ACRONYMS AND ABBREVIATIONS	
EXECUTIVE SUMMARY	1
I. INTRODUCTION	1
II. FREE ZONES: AN OVERVIEW OF BASIC CONCEPTS	2
III. REGIONAL COMPETITIVE ENVIRONMENT	5
IV. FACTORS INFLUENCING ZONE DEVELOPMENT	8
A. Overview	8
B. Institutional and Regulatory Framework for Free Zone Development	8
C. Overview of Basic Economic Factors of Production	11
D. Implications for a Belize Free Zone	18
V. PROJECT DESCRIPTION -- EVALUATION OF THE SANTA ELENA SITE	22
A. Site Selection	22
B. Locational Features	22
C. Infrastructure and Basic Services	23
D. Site Feasibility -- Summarized	26
E. Preliminary Capital Cost Estimates	27
VI. OWNERSHIP STRUCTURE AND FINANCIAL CONSIDERATIONS	31
A. Public/Private Options in Free Zone Development	31
B. Financial Requirements	34
VII. CONCLUSIONS AND RECOMMENDATIONS	42
A. Conclusions	42
B. Recommended Zone Development Characteristics	43
C. Recommended Institutional Involvement	45
D. Proposed Zone Implementation Program	49

PROSPECTS FOR FREE ZONE DEVELOPMENT IN BELIZE

ANNEXES:

ANNEX 1: Case Studies of Competitive Locations

- A. Dominican Republic
- B. Jamaica
- C. Mexico
- D. El Salvador
- E. Costa Rica

ANNEX 2: Public Sector Sources of Finance

ANNEX 3: Maps

- A. Belize
- B. Santa Elena Site

LIST OF ACRONYMS AND ABBREVIATIONS

BBCI	Belize Bank of Commerce and Industry
BEB	Belize Electricity Board
BEIPU	Belize Export Investment Promotion Unit
BTA	Belize Telecommunications Authority
BZ	Belize
C&W	Cable & Wireless, Ltd.
CACM	Central American Common Market
CARICOM	Caribbean Community and Common Market
CBI	Caribbean Basin Initiative
CDB	Caribbean Development Bank
DFC	Development Finance Corporation
EC	Eastern Caribbean
ECCB	Eastern Caribbean Central Bank
EEC	European Economic Community
EPZ	Export Processing Zone
FE	Foreign Exchange
FZA	Free Zone Authority, Ltd.
GDP	Gross Domestic Product
GOB	Government of Belize
IFC	International Finance Corporation
IE	Industrial Estate
IIC	InterAmerican Investment Corporation
IPIP	Infrastructure for Productive Investment Project
LDC	Lesser Developed Country
MFA	Multi-Fiber Agreement
OPIC	Overseas Private Investment Corporation
PBX	Private Branch Exchange
PDP	Peoples Democratic Party
SFB	Standard Factory Building
TSUS	Tariff Schedule of the United States
UK	United Kingdom
US	United States
US AID	United States Agency for International Development
US GSP	United States Generalized System of Preferences

Foreign Exchange Rate: US\$1 = BZ\$2

EXECUTIVE SUMMARY

Purpose. This report examines the viability of establishing a free zone in Belize, and determines the optimal roles for the public and private sectors in the zone development process. It is based upon a research effort conducted by the Free Zone and Privatization Divisions of The Services Group.

Free Zone Context. This preliminary project identification study in Belize has been undertaken amidst a world-wide proliferation of free zones, both in numbers and in kind. Newly Industrialized Countries have employed export processing zones with particular success as a means of promoting jobs and reorienting their manufacturing sectors away from import-substitution regimes. Other countries, such as Jamaica and the Dominican Republic, are now applying free zone incentives as a means of attracting information industries, giving birth to data services zones. Developed countries such as the US and Great Britain are utilizing "enterprise zones" to revitalize distressed areas -- removing barriers to small, indigenous entrepreneurs. Despite variations in emphasis, all free zones work to create favorable policy climates for business development, in which firms have the certainty of minimal tax, regulatory and/or tariff constraints.

Regional Trends. Within the Caribbean Basin, free zones are now making contributions to national development that are surpassed in magnitude only by the freeports and export processing zones of the Far East. Caribbean Basin countries with operating zones such as Jamaica, Costa Rica, Bahamas and the Dominican Republic are rapidly expanding existing facilities and removing supply bottlenecks for the construction of others. New sectors for investment are also being stressed. Under the CBI, for example, agro-industrial operations are increasingly being developed within zones. Lastly, many governments are encouraging the active participation of the private sector, both in zone development and in the private provision of zone services.

Comparative Advantages of the Belize Location. Belize has several advantages when compared to its regional competitors. If properly packaged, marketed and implemented, these relative advantages would likely spur both foreign and local business development in the country, particularly within a free zone. These comparative advantages are:

1. High Political Stability and Democratic Tradition;
2. Favorable Legislative/Regulatory Framework and Investment Climate;
3. Productive, English-Speaking, Highly Literate Labor Force;
4. Abundant Supplies of Land and Other Natural Resources;
5. Unique Industrial-Market Orientation.

This combination of factors is quite unique from a regional perspective, and, from the standpoint of this preliminary analysis, bodes well for free zone development in the country.

Constraints To Be Overcome. There are, on the other hand, a number of factors constraining near-term free zone development potential in Belize. The present analysis has identified the major constraints (relative to regional competitors) that must be addressed. These constraints are:

1. Lack of Technical and Managerial Skills and Small Size of the Belizean Workforce Overall;
2. Inadequate Telecommunications Facilities and Services;
3. Inadequate Air Cargo Services and Linkages;
4. Expensive Electrical Power Supply;
5. Potential Competition From Subsidized Existing Industrial Park;
6. Lack of Adequate Internal Sources of Finance for Zone Development at Requisite Terms and Conditions;
7. Lack of Incentives for Private Free Zone Development.

Other factors influencing zone development potential -- less susceptible to Belizean control -- include the changing access to developed country markets (protectionism); modifications in the provisions and thrust of major preferential trading agreements such as the CBI, GSP, TSUS 806.3/807 and Lome III; and the aggregate effect of changing world demand for free zones precipitated by changing technologies of production.

Assessment of the Proposed Santa Elena Site. The primary site under consideration for free zone development in the country, Santa Elena, ameliorates many of the aforementioned general constraints, while introducing several others. Specifically, the Santa Elena location provides the following distinct advantages for free zone development:

1. Reliable, Plentiful and Relatively Inexpensive Electrical Power for Industry Users;
2. Large, Inexpensive, Industrially Skilled Labor Force with Relatively Abundant Supplies of Technical and Managerial Skills;
3. Historic Development as Major Transshipment Center Between Belize and Mexico;
4. Good Road Connections with Belize City.

The Santa Elena site, however, suffers from the following disadvantages that constrain near-term development:

1. Distant From Major Transportation Hubs -- Airport and Sea Port;
2. Expensive and Inadequate Telecommunications System;
3. Relatively High Costs of Trucking Services and Other Land Transportation.

Estimates of Cost of Free Zone Development. Based on the preliminary site survey conducted, and on experience in other developing countries, the initial development costs of land acquisition and development; building construction; and architectural/engineering design is estimated to be approximately US\$ 6,500,000.

Financing Free Zone Development. Project financing for free zone development is dependent upon the size of the project, profitability, perceived riskiness of investment, and the ownership and management structure of the free zone operating company. The experience of free zones overall has repeatedly demonstrated that a privately owned and operated, user-responsive, economically priced free zone out-performs its public counterparts consistently, while at the same time providing the host country with important economic contributions in terms of jobs, foreign exchange earnings and exports. Moreover, the structure of ownership affects the terms and conditions under which financing is received.

There are a number of financing options for a free zone in Belize. For private zone development, financing is available from: (i) commercial banks with equity contributions; (ii) discount facilities provided by US AID; and in some instances, (iii) government grants combined with private capital. For public sector projects, financing is available -- subject to stringent conditions -- from both multilateral and bilateral sources, namely: the Caribbean Development Bank; The World Bank.

Because of the size of the project, the perceived riskiness, delays in accessing of funds, and stringent requirements imposed, most multilateral sources of financing do not appear to be appropriate for this project. Similarly, given the terms and conditions, high risk perception, and unwillingness to lend long-term, characteristic of the Belizean commercial banking sector, local financing options are limited. The US AID discount facility appears to be one viable financing option, though more research is required.

Preliminary Recommendations for Near-Term Action. The following general recommendations are presented for fostering free zone development in Belize:

Free Zone Development is Both Feasible and Desirable in Belize. Specifically, the initial free zone should be located at Santa Elena, with free zone legislation that provides for multiple siting of zones throughout the country. Institutional effort should be directed toward the assessment of alternative sites for future development.

Market Orientation. The following industry sectors are recommended for initial development:

- Mexican manufacturers wishing to access the US through the CBI;
- Warehousing/Transshipment industries serving Caribbean and Central America;
- Light Manufacturing Industries (garments, electronics assembly, toys and sporting goods, furniture manufacture);
- Agro-Industry utilizing domestic raw materials for processing.

Legislative Structure. The primary impetus for zone development should best come from the private sector with the government playing a facilitating role. A policy environment conducive to zone development and foreign investment should be developed including the following factors:

- establishment of a "one-stop" permit approval center for expedited zone application processing;
- self-provision of zone infrastructure/basic services;
- guarantees against unfair competition from government subsidized projects of similar quality;
- prevention of private monopoly and encouraging effective competition by prohibiting exclusive development rights for any one free zone developer;
- automatic tax, tariff and regulatory incentives to both free zone users and developers.

Ownership and Management. Given the performance of free zones worldwide, it is recommended that a privately owned and managed free zone be established with the public sector playing a facilitating role. Specifically, it is suggested that BEIPU form the Belize Free Zone Corporation to act as a one-stop agency for zone designation, marketing, financing and management, with a Board of Directors drawn from several ministries and the private sector. Finally, effective channels for coordination with the private sector and other government agencies should be established.

Financing Options. To assist the private sector in free zone development, it is recommended that the following legislative actions be implemented:

- equal incentives and benefits to those offered to zone users;
- creation of tax-free loan instruments for lenders to collect interest from private zone developers;

- establishment of debt/equity conversion criteria for the Central Bank to encourage swaps of external debt for local currency investments in free zones;

Physical Development. A minimum 20-acre site should be designated for Phase I development. Initially, 10 acres should be developed, including the construction of 176,000 sq.ft. of building space over a 3-year time frame, in pace with effective demand.

Conduct Comprehensive Feasibility Study. This project identification study, it must be understood, presents a preliminary indication of the free zone development potential of Belize. However, the specifics of effective market demand, optimal zone configuration, and optimal operating structure, cannot be estimated without a detailed feasibility study and implementation plan that can exactly assess these factors. It is recommended that such a study be undertaken immediately.

The results of these suggested actions will be to encourage profitable and effective free zone development in Belize that will catalyze business development, expand exports, increase foreign exchange earnings, upgrade technical and managerial skills and facilitate overall technology transfer.

I. INTRODUCTION

1.01 This report was prepared by Free Zone Authority, Ltd. (FZA), for Coopers & Lybrand under a technical assistance contract with the U.S. Agency for International Development (USAID) dated September 30, 1985. The purpose of the report is to assist the Government of Belize (GOB) in the formulation of a plan for the development of a free zone and in the determination of the optimal roles for the public and private sectors in the zone development process.

1.02 The specific objectives of the assignment include investigation and analysis of the economic and institutional framework in Belize, evaluation of the suitability of the proposed zone site and determination of the competitive position of the project within the regional market environment. Based upon preliminary cost estimates prepared for the project, the study also includes an analysis of the ownership options and alternatives for financing of the zone, including identification and analysis of the terms and conditions of finance offered by various lending institutions. Finally, a work program for the implementation of the free zone project is proposed.

1.03 Field work for the report was carried out by the project team between June 15 and June 27, 1986. Investigations were conducted in Belize City and Belmopan, and a visit was made to the proposed zone site in the Corozal District of Belize. The data gathered in the field, along with the research material collected are analyzed in this report. Moreover, the report contains preliminary conclusions regarding the potential which exists for free zone development in Belize.

1.04 The FZA project team wishes to thank the US AID Mission in Belize and Mr. Jalil Shoroka for their support in the investigation. Messrs. Aldo Baletti and Kim Kennedy of Coopers & Lybrand have also provided valuable assistance in the execution of this study. Ms. Sylvia Cattouse and Mr. Henry Young, along with the other members of the Belize Export Promotion Unit (BEIPU) provided guidance and assistance during the field mission. Finally, all national and local government officials contacted by the project team were extremely supportive throughout the course of the work performed.

II. FREE ZONES: AN OVERVIEW OF BASIC CONCEPTS

2.01 Throughout the world, free zones have been utilized as a means of initiating or accelerating the process of orienting a nation's domestic economy to the world market. In the early stages of industrialization, governments of lesser developed countries (LDCs) tend to adopt strategies and incentives strongly biased in favor of indigenous industries producing for the local market, most often at higher prices and of lower quality compared to world market standards. While there may be justification for this early import-substitution phase of industrial sector growth, it generally creates a network of special interest groups which later frustrate attempts to reorient policy in favor of more efficient export-oriented industries able to compete internationally, penetrate the large markets of the industrial world, and contribute more strongly to economic growth.

2.02 Pending basic changes in government policy affecting the entire industrial sector, free zones are a proven gateway to free trade. The special environment of free zones tends to offset the economic distortions arising from excessively protectionist government policies that restrict the flow of resources into the export sector. Free zones, in effect, provide the cutting edge for export-led economic growth by packaging and promoting a country's existing "inventory" of comparative advantages to primarily foreign investors. Those investors who qualify as free zone export industries are permitted to operate with special incentives and minimum regulatory intervention.

2.03 Free zones can take a number of different forms, including:

- **export processing zones** dedicated to manufacture, i.e., transformation of raw and intermediate materials into finished products;
- **commercial free zones**, i.e., the traditional storage and transshipment zones found in almost all ports of entry (in their simplest form, often referred to as "bonded warehouses");
- **enterprise zones**, where tax and regulatory incentives are targeted toward indigenous firms in areas of high economic distress; and
- **specialized zones** catering to specific sectors such as Data Processing and Information Services, Agro-processing, Duty-Free Shopping, or Financial Services.

2.04 A free zone is a physically or administratively defined area offering liberalized tax, tariff, and/or regulatory conditions for business. Export Processing Zones (EPZs) provide buildings and services appropriate for manufacturing, usually for export but sometimes partly for domestic sale subject to the normal duty. Physically, the EPZ is an industrial estate, which is defined as an area of land selected and developed under the control of an operating agency, subdivided and managed according to a comprehensive plan for the use of a community of industries. Improved land and/or buildings are rented, leased with option to purchase, or sold. Services provided can be of a wide variety, ranging from the basic infrastructure of roads, electric power, gas, water, sewerage and telecommunications to canteens and restaurants, vocational training and business incubation/support

centers. The physical facilities -- land, buildings and services -- are often referred to as the "hardware" of the estate or EPZ as opposed to the enabling legislation and rules and regulations, or "software," governing the operations of the project.

2.05 Beyond duty-free movement of goods, the "software" of the EPZ often includes tax and regulatory relief measures designed to attract foreign direct investment. Firms operating in EPZs are generally offered tax holidays of from five to 25 years, and exemption from foreign exchange controls and restrictions on repatriation of capital and profits. In countries such as the People's Republic of China, free zones have been used as proving grounds for liberalization of restrictive labor codes.

2.06 The above definition applies to the classic enclave EPZ projects as exemplified by the Kingston Free Zone (Jamaica) or the Bataan Export Processing Zone (Philippines). These zones cater to assembly-type industries (such as garments and electronics) for export markets, primarily the United States. In most instances, the fundamental comparative advantage of EPZs has been the availability of a low-cost, productive labor force.

2.07 In recent years, however, the concept of the EPZ has been expanded and adapted to include numerous other activities not necessarily dependent on low-cost labor. Some countries such as Brazil, Bahamas and the People's Republic of China have implemented projects catering to sectors other than assembly-type export industries. In Freeport, Grand Bahama Island, a private corporation has developed a US\$2 billion free zone complex under terms of a 99-year concession granted in 1958. By 1985, the project had installed the largest man-made harbor in the world, an oil refinery, industrial parks for light industry, tourist facilities and hotels, agro-industries, and residential housing and beach properties. In the People's Republic of China, private Hong Kong capital as well as government funds have been invested in infrastructure development in Special Economic Zones. For some projects, low-cost labor has been the key incentive, but access to raw materials and the prospect of selling to the domestic market have also motivated private investors. Finally, in Brazil, a free zone project has been established in Manaus (an area in the heart of the Amazon) for the manufacture of goods based on domestic raw materials. Numerous companies, including U.S. and Japanese investors, have established facilities and the majority of products are sold in the domestic market. The Manaus project exemplifies the role that can be played by free zones as a tool for regional development.

2.08 The numerous "variations on a theme" discussed above are indicative of the broad developmental potential of free zones. One of the critical determinants of the success of any free zone is the identification of a specific market niche based on the country's comparative advantages. Indeed, as the number of free zones has increased worldwide, competition for foreign investment has risen dramatically, a development that has important implications for future zone performance. It is increasingly clear that offering liberal incentives and adequate infrastructure alone is no longer sufficient; such selling points are readily available at competitive zones. Rather, it appears that successful zones will be those that offer a package composed of the following elements:

- stable political and economic climate;
- competitive factors of production;
- simple, blanket incentive programs;
- minimal regulatory controls;
- aggressive marketing and promotional strategy including the identification of a distinctive zone marketing "theme;"
- effective internal control systems in the areas of worker and vehicular traffic flows and zone security;
- provision of zone business support services such as worker training programs and export promotion mechanisms; and
- effective management information systems.

2.09 In the coming years, those free zones that offer a comprehensively attractive environment for international business -- operating within a defined but flexible national free zone strategy -- will be at the forefront of development.

III. REGIONAL COMPETITIVE ENVIRONMENT

3.01 Since their start in the 1960's, a total of 31 export processing zones have been established in 16 of the 27 countries comprising the Caribbean/Central American region. In response to the declining economic conditions experienced in the 1970's, a general policy shift has been evidenced in the region -- moving away from import-substitution industrialization, toward export-led growth, with specific emphasis on the development of non-traditional sectors. Within this context, free zones have increasingly been relied on as an important element among the government's portfolio of development alternatives.

3.02 In 1985, Caribbean/Central American free zones were estimated to have directly employed some 165,000 people, as well as generating as much as 125,000 jobs indirectly./1 Cumulative annual exports from these zones, conservatively assuming US\$10,000/year in sales per worker, amount to more than US\$ 1.6 billion.

3.03 On an individual national level, however, the performance of free zones has varied greatly. In 1984, for example, major Caribbean free zone employment centers included: Haiti (48,000); Dominican Republic (22,000); and Barbados (20,000). Similarly, in terms of contribution to gross export earnings, zones have differed: in the Dominican Republic, free zone exports account for well over 25 percent of total export earnings, while in Guatemala, with over US\$15 million expended in the construction of a free zone and only two occupants, the export impact has been correspondingly minimal.

3.04 Manufacturing activity in the region's free zones is dominated by the garment/apparel industry. The experience of zones in the Far East has shown that, historically, garment manufacturing is the first industry to emerge in the development of a light manufacturing sector for export. As other products begin to take hold -- for example, electronic assemblies, toys, machinery, household goods, etc. -- the importance of the garment sector decreases relatively while the gross export value in aggregate continues to grow. In Hong Kong, during the 1960s, garment exports accounted for 60 percent of total exports; by 1984, this figure had declined dramatically to 35 percent.

3.05 The experience in the Caribbean Basin has been similar, and the reasons, straightforward: the apparel industry requires little start-up capital and utilizes almost 100-percent imported material inputs. Even more important is the fact that, due to the protectionist measures placed on the major Far East producers by the US, sectoral investment has been drawn to the Caribbean/Central American region which remains largely quota-free./2

/1 Not including Mexican border zones which are estimated to directly employ in excess of 250,000 workers.

/2 As of July 1986, the only countries in the region operating under "voluntary" export restrictions under the Multi Fiber Arrangement were: Costa Rica, Dominican Republic, Guatemala, Haiti, Mexico and Panama.

3.06 Unlike many free zones in the Far East however, Caribbean and Central American free zones have extremely limited backward linkages, and as a result, reduced net foreign exchange earnings. Research has shown that the primary reason that free zone companies source almost 100 percent of their raw material inputs from outside the region is the pronounced lack of goods available from indigenous suppliers at internationally competitive prices, quality and delivery schedules.

3.07 This inability to purchase locally has adversely affected foreign exchange earnings. Although foreign exchange earnings have exceeded US\$475 million annually in countries like Haiti and the Dominican Republic, in terms of net foreign exchange, they are dwarfed in comparison to the foreign exchange earnings of Taiwan (some US\$800 million in 1984) where more than 40 percent of inputs are manufactured locally. Foreign exchange earnings in the Caribbean and Central American free zones are limited to payments on such "low ticket" items as rent, labor, freight, utilities and the like, rather than "high ticket" items such as locally sourced raw materials and manufactured inputs.

3.08 Although economic benefits from free zones in the region have proven to be considerable, few free zones sponsored by the public sector have been successful financially. Prices charged for the use of land, buildings and services are not commensurate with the need to meet debt service obligations, cover operating costs, and earn a reasonable return on invested capital. Most public-sector zone rents reflect varying degrees of subsidy. This tendency arises from the belief that uneconomic pricing is needed to attract foreign investment, which will incrementally stimulate economic activity over the long term, thus exceeding short-term financial costs.

3.09 The validity of this argument is debatable: the price of factory space is but one factor among many considered by foreign investors, and generally accounts for less than three to four percent of total operating costs. Moreover, the relative performance of privately owned/operated zones compared to those in the public sector is clear: private zones charging market prices for their facilities have consistently out-performed their public counterparts in almost a dozen developing countries. Users readily pay the higher rental rates to be assured of responsive property management, higher aesthetic standards, better maintenance of infrastructure, and fewer delays in building construction.

3.10 Some countries in the Caribbean have become more responsive to the issue of economic pricing of infrastructure in particular, and a greater role for the private sector in free zone development and operations in general. Through the provision of a US AID-funded long-term, low-interest financing facility, private developers are implementing industrial estate/EPZ projects in several countries of the Eastern Caribbean. In Jamaica, the Government has recently announced the privatization of a key aspect of its free zone infrastructure -- international telecommunications links -- as a means of attracting labor-intensive information industries, and operations are underway in its first privately owned EPZ. And in Costa Rica, the privately owned EPZ at Cartago continues to expand rapidly, charging market rates, while the public sector projects at Moin and Punta Renas are languishing despite the "attraction" of subsidized pricing.

3.11 The near-term outlook for free zone development in the Caribbean and Central American region is encouraging.^{/1} Most countries are rapidly expanding the size and number of existing facilities, as well as removing supply-bottlenecks for the construction of others. Countries like El Salvador, Costa Rica, Guatemala, and Bahamas are reviewing various free zone options in order to formulate national strategies to guide future zone development. The Dominican Republic already has four export processing zones in operation, two under construction, and another nine designated for startup. Countries are increasingly tapping new and diverse sources of foreign investment, including the Newly Industrialized Countries of the Far East. Finally, in response to changes in developed country market-access, new sectors of opportunity are arising. Because of the duty-free treatment given to many agricultural products under the CBI, for example, many countries are diversifying agricultural export production and encouraging foreign investment in agro-processing industries.

^{/1} See Annexes for case studies on free zone development in the Dominican Republic, Mexico, El Salvador, Costa Rica, and Jamaica.

IV. FACTORS INFLUENCING ZONE DEVELOPMENT

A. Overview

4.01 In this section, the advantages and disadvantages of the Belizean investment environment will be detailed and assessed in order to identify market opportunities and constraints from the standpoint of free zone development. These will then be briefly compared to the resources, incentives and facilities offered in select competitive locations regionally -- specifically, Jamaica, Costa Rica, Dominican Republic, Mexico and El Salvador -- as a way to target relative advantages and disadvantages proffered by a Belize location.

4.02 As in many other developing countries, the economy of Belize has historically been based on its wealth of natural resources. The sugar industry has been the mainstay of the economy for over 50 years, surpassing forestry as the primary export income generator for Belize in the 1930s. At present, sugar accounts for more than 60 percent of export earnings and contributes 20 percent to overall GDP. With a population of 165,000 people, the small size of the domestic market in Belize has severely limited the development of the manufacturing sector, and slowed the process of economic diversification. At the same time, falling sugar prices in the international marketplace, coupled with tightening quotas in the United States have resulted in a drastic decline in sugar exports in recent years, and contributed to diminishing GDP growth rates for the country.

4.03 In order to expand and diversify the national economic base, the Government of Belize (GOB) has placed a high priority on the development of new avenues for investment in Belize and the cultivation of both domestic and foreign manufacturing, agro-processing and service activity. It is within this context that the prospects for the development of a free zone in Belize should be considered.

4.04 The following subsection reviews and examines the institutional, regulatory and legislative framework of Belize, in order to gauge the overall investment climate. Next, the relative resource endowments of the country, and the quality and cost of its basic factors influencing production are analyzed, and implications drawn for free zone development potential. The final section aggregates and summarizes the relative advantages and disadvantages for productive investment in Belize, and assesses the overall potential for successful free zone development.

B. Institutional Environment and Legislative and Regulatory Framework

1. Regulatory and Legislative Framework

4.05 The Belizean economy, in contrast to many developing countries, offers a largely open, strongly free-market orientation with the private sector heavily involved in almost all forms of business activity. The role of the government is largely restricted to the provision of public services and infrastructure, and the overall formulation and implementation of national economic policies.

4.06 The legislative and regulatory framework governing economic activity in general, and foreign investment in particular, is outlined in the Belize Investment Code. Belize encourages foreign investment which involves the transfer of financial resources, appropriate technology, and management skills and expertise. Specifically, investment incentives are available to those foreign firms which: utilize indigenous raw materials, produce for the export market, and contribute to the employment and upgrading of skills of Belizean nationals. Top priority is given to the following industry sectors:

- o agriculture and agro-industry;
- o tourism and tourism-related activities;
- o forestry;
- o export-oriented light manufacturing/offshore assembly industries;
- o aquaculture; and
- o deep-sea fishing and processing.

4.07 More important and significant are the very favorable incentives offered both foreign and domestic investors in select industries -- subject to certain requirements -- codified in Chapters 40 and 45 of the the 1980 Laws of Belize,/1 namely:

- o corporate income tax holiday up to 15 years;
- o no import duties on machinery and equipment (as well as raw materials where the final product is re-exported, plus spare parts for specialized machinery);
- o exemption from dividends tax on profits earned during tax holiday (up to the amount of shareholder's investment);
- o guaranteed repatriation of investment plus profits and returns from capital gains;
- o carry-forward of net losses incurred during tax holiday;

In addition, special incentives are offered to encourage investment in less developed areas of the country, export-oriented projects, and projects involving the introduction of technologies not available in Belize.

4.08 However generous these incentives, the regulatory procedure required to receive the development concessions is somewhat long -- as many as five institutions are involved, and the entire decision-making process takes, at a minimum, 60 days.

4.09 Direct foreign investment is welcomed and 100-percent foreign ownership is allowed, although joint ventures with local participation are encouraged. Free repatriation of capital and profits is permitted, provided the foreign party is registered with the Central Bank of Belize and "approved status" has been granted.

/1 The length and scope of the incentives offered are determined by: the extent of local value added; the profitability of the enterprise; the foreign exchange earnings/savings; and employment opportunities created.

4.10 Lastly, Belize has excellent access to industrial country markets when compared to regional and international competitors, through a broad and unique combination of preferential trade programs, namely:

- o US Generalized System of Preferences. Under this program, over 2,800 product categories can enter duty-free into the US (subject to a 35 percent local value-added requirement);
- o TSUS 806.3/807. These tariff provisions offer duty-relief to items in proportion to the percentage of US components comprising the imported product;
- o Caribbean Basin Initiative. This program allows for the duty-free entry to the US of a wide variety of goods from designated beneficiary countries;
- o Lome III. The convention provides preferential (duty-free) market access to the EEC to a wide number of products exported from designated African-Caribbean-Pacific (ACP) countries;
- o Caribbean Community and Common Market. The common market arrangement allows for duty-free access to the markets of the 12 English-speaking countries of the Caribbean: and

4.11 Taken as a whole, the incentive package and market access programs are very competitive with regional and most international competitors. Moreover, it is clear that Belize has a liberal investment environment, which is, in fact, closely related to many elements of free zone legislation found in countries around the world. However, as will be explained in a later section, there are a number of very important differences in both the content and implementation of most free zone-specific laws/incentive packages that set them apart from the existing Belize investment ordinances.

2. Institutional Setting

4.12 The government is strongly supportive of free trade and seeks to attract foreign investment to Belize. In order to further the realization of national economic development goals, the Belize Export and Investment Promotion Unit (BEIPU) was recently established. The organization is housed within the Chamber of Commerce and Industry, and is responsible for facilitating investment inquiries.

4.13 BEIPU has taken an active role in promoting investment in Belize both domestically and abroad, sponsoring trade missions to the United States, Mexico, the Far East and Central America. Effort has also been directed toward arranging joint venture partnerships between foreign and domestic investors, especially those which will provide international market access for Belizean products.

4.14 Originally capitalized with the assistance of US AID, BEIPU has recently been given an additional allocation of US\$ 2 million for the

expansion and continuation of their work. Under this US AID program, account executives will be recruited for agriculture, tourism and industry. Given the orientation of BEIPU and the promotional requirements for any major industrial development initiative, it would appear to be an appropriate vehicle for the marketing and publicizing of the Belize free zone project.

4.15 Considerable public and private sector interest has been demonstrated in Belize in the realization of a free zone. At present, while generous incentives are in place to encourage investment throughout the country, there is no national free zone legislation. During the past year, BEIPU became interested in the possibilities which exist for Belize to further its economic expansion through free zone development, given the proven successes of zones throughout the region in attracting foreign investment. Preliminary investigations into the actions needed and potential benefits of establishing a free zone in Belize were begun. Due to a number of economic and social factors, the Santa Elena site was considered to be the optimal potential location, and, consequently, the focus of this study.

4.16 Concurrently, a similar initiative was underway within the Belize Ministry of Commerce, Industry and Tourism. A free zone committee was formed to examine the potential for a free zone, also considering the Santa Elena site. While the work conducted by the FZA project team is at the request of BEIPU, the input of the Commerce committee has also been solicited and is incorporated in this analysis.

4.17 Based upon the existing institutional structure and the initiatives undertaken to date the following conclusions can be drawn:

- o there is broad private and public sector support for the project;
- o BEIPU has taken the lead in generating the economic and technical analysis necessary for the realization of the project;
- o BEIPU, various ministries, and US AID are prepared to work together in the further development of the free zone initiative.

C. Overview of Basic Economic Factors of Production

1. Land and Buildings

4.18 Land is plentiful and inexpensive in Belize. With a total land area of 5.2 million acres the population density is one of the lowest in the world, approximately 18 persons/square mile. According to government statistics, the price of land in Belize ranges from US\$30 to US\$200 per acre, while lease rates for unimproved land average US\$2.50 per acre/year. Land for both lease and purchase is readily available throughout the country.

4.19 The land tenure policies of the country are basically sound; the GOB welcomes foreign ownership of land. The primary piece of legislation affecting foreign land purchase is The Aliens Landholding Ordinance of 1973, whose main provision requires that non-nationals obtain a license for land purchase. The intent of the law is to prevent outright speculation and promote active investment.

4.20 In terms of office and factory building facilities, the public sector provides standard factory buildings (SFBs) and warehousing space through the Development Finance Corporation (DFC). Historically, most of the financing handled by the DFC has been for agro-related projects. However, using financing provided by the Caribbean Development Bank (CDB), the DFC has constructed 18,000 sq.ft. of factory/warehousing space at the Ladyville Industrial Estate, outside of Belize City.

4.21 It must be strongly emphasized, however, that Ladyville is in no way a "fully serviced" industrial estate: there is little or no maintenance of facilities and infrastructure, grossly inadequate provisions for storage, entry and egress; support services are almost non-existent; and almost all utilities (telecommunications, power, water/sewerage, etc.) are inadequate. SFB space in the industrial estate is currently leased to businesses at a subsidized rental rate of US\$ 1.50/sq.ft./year. Moreover, the DFC has recently submitted a request to the CDB for a US\$2.1 million loan for the development of an additional 64,000 sq.ft. at Ladyville and 6,000 sq.ft. in Belmopan. The aggregate effect of these actions would be to greatly compromise any privately oriented, economically priced free zone, as will be discussed below.

4.22 Implications for Free Zone Development. The land policies outlined above bode well for free zone development. Complete, and uncontested ownership of land (rather than, say, securing land-use rights under a long-term lease) is attractive to foreign developers as debt financing is easier to obtain. The cost of land, moreover, compares favorably with other regional locations. On the other hand, with respect to factory space and other facilities, it must be emphasized that if, in fact, the expansion of the Ladyville Industrial Estate is undertaken as envisaged, and leased at the present grossly subsidized and uneconomic rate, the potential demand for a free zone with realistic lease rates reflecting cost-recovery will be greatly impeded.

2. Labor

4.23 The Belize labor force numbers an estimated 47,000 persons. The supplies of both unskilled and semi-skilled labor appear adequate to support future industrial development, but there is a marked shortage of skilled labor, technicians and management. Consequently, the policy of the Belize government has been to allow the importation of workers in those vocational areas where domestic skills are in short supply. The majority of the labor force is located in the large population center of Belize City.

4.24 Historically, especially within the agricultural sector, Belize has experienced a seasonal labor influx from the neighboring countries of Central America. Citrus, sugar and banana harvests draw itinerant workers from throughout the region each year, most of whom return to their homelands at the end of the season. This movement has helped to alleviate any manpower shortages that might otherwise be experienced in the labor-intensive agricultural sector. Moreover, in some cases, Mexico has been the source of the requisite technical and managerial personnel needed for industrial operations.

4.25 The national literacy rate has been placed at above 90 percent for adults, one of the highest levels in the region. Under a recently launched US AID training program in Belize, funding has been made available for vocational, technical and managerial instruction linked to the needs of the Belize business community and high potential foreign investors. During the four years of the "Training for Employment and Productivity" project, outside consultants working in conjunction with a local training institution will endeavor to develop the job skills of the Belize citizenry and thus increase productivity in the workplace. At present, knowledgeable observers place Belize labor productivity at levels similar to their regional counterparts. Reportedly, labor in some regions of the country have productivity levels approximating 70 percent of US levels.

4.26 For the purposes of this study it is important to note that skilled and unskilled labor, and limited supplies of management personnel, are readily available at the potential free zone site at Santa Elena due to the recent closing of the Libertad sugar mill.

4.27 In 1985, the average wage for unskilled workers was approximately US\$0.67/hour without fringe benefits; fringes add approximately 20 percent to wage rates. The wages paid to employees in export manufacturing are higher than the standard wage -- an estimate for unskilled labor in apparel manufacture, for example, was about US\$0.90/hour. Overtime is paid at the rate of 1.5 times the normal wage in excess of 9 hours per day or 48 hours per week. Holiday pay is in effect for workers, ranging from 1.5 to 2 times the normal wage, depending on the occasion. A two-week vacation is also standard for employees./1

4.28 Although most of the public sector, service and trade industries in Belize are unionized, relations between unions and management have been generally good. Isolated problems have arisen regarding the union at the port in Belize City, with truancy, tardiness, low productivity and some instances of pilferage among the workers. However, steps have been taken to strengthen supervision of the dockside workers by the Port Authority. In export manufacturing, there have been no attempts to unionize in Belize.

4.29 Implications for Free Zone Development. A critical requirement of most developing country free zone projects is the ready availability of and accessibility to, plentiful and inexpensive supplies of both unskilled and skilled labor. The savings in labor rates are perhaps the most critical factor in offsetting the increased costs of logistics management, transportation, etc, in motivating labor-intensive processes to locate offshore. Viewed in this respect, the prevailing wage rates and productivity

/1 According to a recent Coopers & Lybrand report on Belize ("Belize: Investing in the Caribbean," undated) the minimum wage in Belize for unskilled workers is US\$ 0.72/hour; semiskilled workers -- US\$ 0.88/hour; clerical workers US\$ 1.15/hour; and skilled workers -- \$1.38/hour. The report is unclear as to whether these wages are, in fact, mandated by government legislation. In any event, as is the case with most LDCs, in practice there is great flexibility in wage rates in Belize. According to some observers, reliable unskilled labor is available at rates as low as US\$0.33/hour.

of Belize labor appear to be competitive with countries in the Eastern Caribbean, though the US\$0.67/hour rate appears to be in the "high-end" of the scale compared to other countries such as Jamaica, Haiti and the Dominican Republic. (Unburdened wage rates for unskilled labor range from US\$ 0.33/hour in Haiti to US\$ 4.80/hour in Puerto Rico, with the mean at about US\$ 0.48/hour.)

4.30 It is noteworthy, lastly, that supplies of labor and management skills appear to be aggregated in certain areas: in Belize City and the proposed free zone site of Santa Elena. In particular, Santa Elena appears to have many advantages in this respect: not only are there relatively abundant supplies of unskilled, technical and managerial labor, but the existing workforce already has an "industrial discipline" from working at the Libertad Sugar mill.

3. Capital

4.31 The supply of both public and private sector capital in Belize is limited and largely inaccessible for non-traditional and longer-term projects. While sufficient liquidity exists in the banking system, there are a number of very important constraints, as discussed briefly below.

4.32 There are currently four commercial banks in Belize -- three subsidiaries of international banks and one of domestic origin. All of the institutions share certain and, from a development finance perspective, limiting, characteristics:

- o they are wary of longer-term investments due to lack of confidence in the overall investment climate and lack of experience in project lending generally;
- o interest rates are set by the Central Bank; the prime lending rate is currently 14 percent -- too high for many development projects;
- o unrealistic requirements in terms of prior experience and track record of potential borrowers.

4.33 In addition, there is no concessional mortgage financing facility in the country. Traditionally, banks have made their funds available only for short-term lending, usually in the form of trade finance and overdraft facilities.

4.34 Implications for Free Zone Development. Investments in free zone land development, buildings and support facilities are inherently long-term, typically amortized over 20 years or longer. They require, therefore, long-term finance (ie, with a repayment period of no less than 8-10 years), at reasonable rates (approximating the U.S. prime rate). Both the unavailability of funds and the difficulty in accessing them at requisite terms and conditions within the domestic banking system, make the external financing of a Belize free zone project almost a necessity.

4. Basic Services

a. Power

4.35 The fundamental lack of an adequate supply of electricity in Belize is a major obstacle to industrial development. Power provision in the country is fragmented, very expensive and unreliable -- there is, overall, only a 12 megawatt capacity in the country, and no national power grid. Brown outs, fluctuating voltage, and high rates all deter potential investment in projects with high power requirements.

4.36 The Belize Electricity Board (BEB), a government monopoly, has the exclusive right to generate, transmit, distribute and sell power. BEB has historically been unable to keep pace with demand and interruptions in transmissions are frequent. Belize has no domestic source of petroleum, despite extensive oil exploration during the 1980s no substantial deposits have been found on or offshore. As such, importation of Mexican diesel is necessary to meet domestic requirements.

4.37 There is no differentiation between residential usage and commercial or industrial rates in Belize. A single rate of US\$0.215/kwh is in effect, at all times of the day, for all types of activities. This is nearly three times the U.S. standard and double the average electricity charge for industrial activities in the Caribbean and Central American region. In El Salvador, for example, the present charge is US\$0.11/kwh, Costa Rica -- US\$0.05-US\$0.07/kwh, and the Dominican Republic -- US\$0.15/kwh. In sum, in addition to a fundamental lack of quality and reliability in service provision, Belizean power is comparatively expensive, presenting a major obstacle to further industrial development.

4.38 In response to this situation, the World Bank has authorized a US\$15 million loan for improvements in the distribution and transmission infrastructure of the existing system. The scope of these improvements, however, appears to be very limited. /1

4.39 Implications for Free Zone Development. The provision of a generally reliable power supply at competitive rates is a critical requirement for most free zone industries. Certain industrial sectors such as data entry/processing and pharmaceuticals/chemicals are critically dependent on a reliable power supply. Moreover, the cost of electrical power in Belize is, as indicated, expensive: far above most regional competitors. It must be noted, however, that the situation in terms of power supply at the potential free zone site of Santa Elena is positive and unique, as will be detailed in a later section. In essence, Mexico will make available plentiful supplies of electricity at favorable rates. Notwithstanding, given the present situation in Belize -- with the supply of electrical power being expensive, unreliable and not likely to change in the near-term -- the need to locate the zone near more reliable supplies of electrical power is critical.

/1 According to World Bank officials, these funds cannot be used for expansion of the existing distribution system, nor the installation of new facilities; neither can changes be made in the existing electricity rate structure. The World Bank program does not anticipate any additional investment in power infrastructure until the early 1990's.

b. Transportation Infrastructure/Services

- 4.40 The transportation network of Belize is currently comprised of:
- o 1,400 miles of roadways, of which only 250 miles are paved; 200 miles of unimproved roads and tracks; and 250 miles of urban streets;
 - o a semi-deep water port at Belize City (with a single lane trestle; a passing bay which connects the shore mid-way to a pierhead of 25,000 sq.ft.; and a draft of about 17 ft.); and two other shallow ports located in the southern part of the country; and
 - o an international airport (9 miles west of Belize City; 6,300 ft. runway, 150 ft. wide, able to accommodate DC-9 and Boeing 720, 727 and 737 aircraft); 11 government air strips, and 8 private airstrips.

4.41 The road network is generally considered to be adequate, though sometimes subject to flooding and washouts during heavy rains. Overall maintenance, however, appears to be spotty, and expenditures on improvements, insufficient. The port facilities are satisfactory for present demands, but there are several constraints: a problem with silt accumulation, a lack of any warehousing space, and general problems with security and pilferage. Lastly, the landings at the international airport are currently restricted to daylight hours, as night facilities are unavailable. A new passenger terminal to encourage tourism is being planned for construction within the next two years.

4.42 Adequate overland trucking services are available, connecting Belize City to destinations throughout the country and to Mexico and the United States. Sea cargo service between Belize and most international ports in the U.S., Europe and the Far East is frequent and reliable. The average cost for northbound cargo is US\$2,500-US\$3,000 per forty ft. container; southbound cargo is generally 10 percent more expensive. Charges for the shipment of a 20 ft. container from Japan, in contrast, average US\$3,800. Air cargo services available in the country, however, are problematic: although some three international airlines service Belize City airport, cargo services are generally said to be unreliable; flights frequently delayed; and at times, cargo may be bumped to accommodate passenger baggage. On the other hand, if demand levels increase, it is likely that service would improve.

4.43 Implications for Free Zone Development. Free zones are generally located near air and sea ports and other transportation hubs as their operations are highly dependent on the efficient movement of required materials. The cost of transportation, while dependent on the specific nature of the process considered, is a major component of operational costs for most free zone industries. Viewed from this perspective, the situation in Belize appears to be mixed: trucking and sea cargo services to Belize City appear to be relatively accessible, reliable and generally competitive vis-a-vis other free zones, but air cargo services, are at present, inadequate. It must be emphasized that, at this stage of preliminary analysis, hard and fast trade-offs between different modes of transportation cannot realistically be made without intensive relative cost analyses. It

may be that trucking overland through Mexico is a cheaper and more direct route for the western U.S. market if Mexican truckers are used. On the other hand, for some goods, efficient air transport is a necessity. Similarly, it is evident that if demand for air cargo services increased, overall efficiency would also increase utilizing existing international connections. Suffice it to say then, that the cost-effectiveness of a particular mode of transport varies greatly with the location of the Belize zone, the type of product/process involved; and a plethora of other factors which must be further analyzed.

c. Communications

4.44 Telecommunications in Belize falls under the supervision of the Belize Telecommunications Authority (BTA). The authority was established in 1982 to operate, maintain and administer the national communications service throughout the country and to regulate, control and plan all other internal and external telecommunication services. International services are provided by Cable and Wireless, Ltd.(C&W), of Great Britain. C&W leases 45 channels from Intelsat for international service and reports a 25 percent per annum increase in the amount of international traffic in recent years. There are only a few leased lines in Belize, used primarily for military and diplomatic services. Leased lines are available from C&W at US\$4,000 per month. No private businesses -- reservations, travel and hotel booking systems, data entry, etc., maintain private lines. The international services lease expires in 1987 and is presently the subject of serious negotiation.

4.45 The existing system in Belize is analog, with basic service available in Belize City at a rate of US\$4.00 for installation and US\$5.00 for monthly service. Telephone communications have improved in recent years. In early 1979, BTA began a major expansion program in the number of lines provided. In 1982, approximately 5,000 connections were available for customers and today the BTA has over 8,000 subscribers. The cost for a phone line in the Santa Elena area, however is prohibitively expensive -- US\$135/month. This is due to insufficient demand in the area, and consequently limited trunk capacity. According to the BTA, the level of demand would have to increase 100 times before direct service would be economically feasible. The communications options presently being considered for Santa Elena and Corozal are discussed more fully in Chapter V.

4.46 Implications for Free Zone Development. Increasingly, the availability of reliable and efficient telecommunications services for voice and data communications is becoming a major factor in the development of free zones worldwide as new information-intensive and time-sensitive operations (such as data entry) move offshore. Given both the high cost and poor quality of the existing telecommunications system (primarily telephone) in Belize generally, and in and around the Santa Elena site specifically, the need for upgrading facilities and improving service is urgent. At this stage, it is not clear what specific actions will be required. It is quite possible that a private branch exchange (PBX) switching facility will be necessary for the free zone site. Similarly, great advantages could accrue to the zone if the costs of point-to-point international satellite communications were lowered from the current US\$4,000/month rate for privately leased lines. (It appears that costs could be lowered, given that C&W rents circuits from INTELSAT at roughly US\$ 1,000 per month.) A similar initiative in one of the free zones

in Jamaica has helped that country attract large numbers of data entry, telemarketing and other operations reliant on telecommunications.

d. Water and Sewer

4.47 Belize's potable water is of generally high quality and in plentiful supply. However, Belize City suffers from grossly inadequate sewerage and excavation is presently underway to completely renovate the system. The water supply at the Santa Elena site can be drawn from wells and the nearby river and appears to be adequate for industrial requirements, as discussed in the next chapter.

4.48 Implications for Free Zone Development. Apart from the unsatisfactory sewerage system in Belize City, the provision of sewage facilities and water supply in Belize overall appear to be adequate. The particular conditions of the final free zone site are, of course, unknown at this point and will have to be determined to pinpoint specific deficiencies. The development of other free zones has often required the construction of water storage tanks of sufficient capacity to handle peak-load requirements, and in some cases, special sewage treatment plants have had to be located onsite. Much depends on the levels of demand, and types of industry occupying the zone.

D. Implications for a Belize Free Zone.

1. Comparative Advantages/Disadvantages of the Belize Location

4.49 As a potential site for the development of an export processing zone, Belize has a number of important advantages and disadvantages relative to competitive locations. In the following section, the large number of variables discussed above -- institutional and regulatory framework, economic factors of production, relative resource endowments, infrastructure, etc. -- are distilled in order to identify specific opportunities and constraints inherent in the Belize context. In the final part of this section, potential market opportunities are identified.

4.50 The following relative advantages are presented by the Belize location:

High Political Stability. The value of a stable political and business climate, sensitive to the needs of the private sector, cannot be overstressed. In this respect, Belize stands out from its neighbors, as a pre-eminent location for business. With its strong parliamentary tradition, democratic ideals, and pro-private sector stance, the Belize environment is highly attractive especially in contrast to the political, economic and social turmoil characteristic of the Central American region.

Favorable Legislative/Regulatory Framework. Belize has an added advantage in that its legislative and regulatory framework is already highly supportive of the private sector in general, and foreign investment in particular. What must be emphasized however, is that the present investment ordinances, however favorable, differ from most free zone legislation in a number of specific respects: First, they are

not as comprehensive -- free zone incentives in general, offer significant relief in three areas; fiscal (tax) abatement incentives, duty (tariff) abatement incentives, and "regulatory" incentives. The last category subsumes "incentives" as diverse as the provision of a "one-stop" administrative center (where all requisite legal, regulatory requirements are fulfilled at one location) to the provision of worker training and business incubation centers. Secondly, the sine qua non of free zone incentives is that they are automatically applied; ie, decisions are not made on a case-by-case basis per se, but rather free zone incentives are applied comprehensively and automatically within a finite (and stated) time period upon satisfactory completion of the potential zone user's application form. As is detailed in our recommendations, there are a number of ways that Belize can become more competitive in this respect.

Finally, it must be noted that, while the content of policies, laws, regulations and procedures is of major importance, clarity, stability, and consistency of application are equally critical. Foreign investors are generally prepared to assume the "business risks" associated with the vagaries of the market and swings in economic activity. They may also be willing to accept certain less-than-ideal policies and regulations if they can be sure that these will remain stable over the life of the investment. On the other hand, businessmen react strongly and negatively to unanticipated changes in the "rules of the game." Foreign investors, in particular, place a very high premium on clarity and predictability of host government policies. Indeed, in the final analysis, it is less the content of government policies per se, than the perceived unpredictability of policies that makes many foreign firms reluctant to invest in developing countries. In this light, the environment in Belize, from the standpoint of this preliminary analysis, appears to be exceptionally bright.

English-Speaking, Highly Literate Labor Force. Another relative advantage of the country -- viewed from a regional perspective -- is the fact that almost 90 percent of the adult population is literate (very high for a developing country), and second, that the population is English-speaking. Both these factors bode well, as explained below, for the attraction of information-intensive, offshore data entry and data processing industry. Moreover, relative to regional competitors, the average wage rates for Belize are fairly competitive.

Abundant Supplies of Land and Other Natural Resources. Perhaps the greatest natural resources of Belize are its plentiful supply of land for development and its timber reserves: indeed, there are substantial opportunities for agricultural expansion, the production of furniture and general exploitation of the country's hardwood resources.

Unique Industrial-Market Orientation. Belize has preferential access to the United States through the GSP, TSUS 806.3/807 and CBI programs; to the EEC through LOME III; and to the Caribbean common market through CARICOM. This fact, though not so significant at first glance, is tremendously important from a zone marketing perspective. The variety of preferential trading arrangements would be an added attraction, especially to multinationals seeking to broaden their market. More important perhaps, is the unique opportunities it offers

regional firms: Mexico, for example, is not one of the designated beneficiary countries of the CBI program. Mexican producers, as a result, are denied preferential entry of their exports. An export processing zone in Belize can provide the location from which to access not only the US market but the European, Central American and Caribbean market preferentially. This unique access is unparalleled by any competitor country.

4.51 On the other hand, there are a number of important relative disadvantages to the Belize location in comparison to its regional competitors. The small size of the labor force, shortage of management and technical skills, and wage rates which are higher than many other regional locations may discourage some labor-intensive industries from locating in Belize. The inadequacies of the telecommunications system and high costs for phone service in some locations may deter the development of the information industries, a sub-sector which would also require reliable air cargo service that is presently not available. Finally, the inadequacies of the electricity system and the high cost for industrial consumers will certainly discourage further economic development, if left unaddressed.

2. Potential Investment Demand

4.52 In order to arrive at a firm determination of demand potential for any business venture, a market survey is essential. Such a methodical analysis of the prospective market is not within the scope of this report. However, preliminary conclusions regarding the potential market for the project can be drawn based upon the comparative advantages offered by Belize, as detailed above, and the considerable interest that has already been evidenced by investors.

4.53 A free zone project in Belize would appear to be an effective mechanism for attracting a portion of the Hong Kong out-migration presently underway. The Government of Belize has recently installed a citizen investment program which has attracted applications from numerous Hong Kong nationals to date. When coupled with the investment incentives offered in a free zone, increased Far Eastern interest should be drawn to the country. The possibility for accessing the U.S. market via the CBI, avoiding quota restrictions, and relocating in an English-speaking country are powerful attractions for these investors, according to BEIPU representatives.

4.54 As discussed above, since Mexico is not a beneficiary of the CBI, Mexican products are not provided preferential access to the US market via the program. Consequently, Mexican manufacturers seeking to export to the U.S. market duty-free via the CBI or reluctant to set up operations in the relatively costly frontier zone along the U.S.-Mexican border have also displayed a strong interest in participating in a Belizean free zone project. Sourcing raw materials from Mexico and processing in the Santa Elena border area provides the opportunity to tap into a bi-lingual labor force and utilize Mexican technical assistance, while investing in regional economic development. This last factor is especially important politically for a business community that has taken criticism for contributing to the widespread capital flight from Mexico in recent years. Again, discussions held by the project team in Belize indicated considerable Mexican interest in the project.

4.55 Moreover, the data gathered and preliminary analyses conducted by the project team point to specific industries that should be targetted if and when the free zone is developed. The Santa Elena site would appear to be well positioned to attract light manufacturing -- electronics, garments, wooden furniture, etc. -- with its readily available labor force and potential for reliable, competitively priced electricity. The efficient and rapid land transport network in Belize has already proven to be able to meet the needs of the export garment industry. The Williams & Dickey factory located in Belize City has had great success, relying entirely on trucking for both the raw materials and finished goods. Moreover, containerized cargo brought into the port at Belize City could be trucked to the zone site for processing. Finally, agro-industrial businesses could be attracted to the zone for the processing, blending and packaging of their produce. For those firms utilizing foreign-sourced materials in the preparation of processed foods, sizeable benefits could be realized in a free zone location.

4.56 The following chapter addresses the characteristics of the Santa Elena site and their effect on the prospects for the development of the zone project. Again, it should be noted that a more detailed examination of the market is essential to the accurate projection of free zone performance in any country and should be undertaken in Belize as part of a full feasibility study.

V. PROJECT DESCRIPTION -- EVALUATION OF THE SANTA ELENA SITE

A. Site Selection

5.01 Although there are many exceptions, port areas (maritime or air) generally offer the most feasible locations for free zones. There are special considerations, however, which in Belize point to the Santa Elena area of the Corozal District as the most promising site for the nation's first formal free zone. Essentially, the close proximity of the Mexican border suggests the possibility of reviving the international transshipment activities that once flourished in Santa Elena. Taking it one step further, because of Belize's status as a beneficiary of the CBI program, it is conceivable that certain types of semi-finished goods from Mexico could be upgraded to finished products in a Santa Elena industrial free zone and qualify for duty-free entrance into the U.S. market.

5.02 To a great extent then, the top priority status assigned to the Santa Elena site rests on its potential as a future major point of entry and exit along Mexico's southern boundary. However, an additional factor must also be considered, the Santa Elena location presents the opportunity to draw affordable, reliable electric power from Mexico -- a crucial element in the site's attractiveness given the high cost of electricity in Belize and the problems encountered in its transmission.

5.03 As dictated by the time and budget limitations of this study and as outlined in the scope of work, field research conducted by the project team was intended to determine the feasibility of the Santa Elena site. As will be discussed below, preliminary investigations find the site suitable for development. It should be stressed, however, that there are additional locations within Belize which also offer compelling attributes which warrant future consideration for free zone development.

5.04 Long-range planning should envisage a second free zone project in or near Belize City, a location which would enjoy the advantages of proximity to the country's major seaport and only international airport. Over the long term, multiple sitings should be considered as a possibility, particularly for agro-processing activity which most often requires the location of industrial facilities at the source of raw materials. By combining the local resources with imported components in packaging, bottling etc., these businesses could benefit from free zone status as well.

5.04 The balance of this chapter focuses only on the Santa Elena site. Available descriptive data is discussed and analyzed for the purpose of establishing a credible basis for the preliminary capital cost estimate outlined in Section D.

B. Locational Features

1. Physical Characteristics

5.05 The land presently under consideration for the free zone is in the Santa Elena area of the Corozal district. Corozal is one of the primary sugar growing areas of the country and is suffering from the economic effects

of the closing of the Tate & Lyle sugar mill. The site itself is bounded by the "Four Mile Lagoon" to the east and south, and on the north by the Rio Hondo river, the international boundary between Belize and Mexico. The western boundary of the 332-acre parcel is the Santa Elena-Corozal road, a major north-south artery.

5.06 The Santa Elena parcel is owned by an American developer. Most of the proposed site area is presently covered with vegetation and undeveloped. However, there is a developed area adjacent to the site. The facilities comprise a small recreational area located alongside the lagoon, the Belize Customs and Immigration post at the border, and a 40-acre, fenced bonded warehouse area and duty-free shopping facility. The trading center was constructed to service the once booming re-export trade with Mexico and is now all but abandoned due to the devaluation of the peso. Raw land values are reported to range from US\$ 30-50/acre.

2. Economic and Demographic Characteristics

5.07 The population of the Corozal area is almost entirely bi-lingual due to the proximity to and shared heritage with Mexico. According to the 1980 census figures, the population of Corozal town is approximately 8,500 persons, assuring sufficient labor supply for zone development over the medium term. Although the sugar industry has played the most prominent role in the economic development of the area, at one time the area economy also relied heavily on import/export activity with Mexico. However, this activity peaked in 1981, after which the falling value of the peso resulted in a drastic reduction in transshipment activity.

5.08 During the field visit by the FZA team, area residents voiced extreme dissatisfaction with the level of support the re-exportation operations had received from the Government of Belize. In the early 1980s, several local businessmen invested in the construction of the bonded warehousing, retailing and wholesaling operation at the border anticipating government endorsement of the initiative and, eventually, free zone designation -- which did not occur. The present downturn in trade with Mexico, coupled with the declining fortunes of the sugar industry have produced considerable losses for these entrepreneurs.

5.09 Apart from a small-scale garment manufacturing business and a broom-making operation, there is currently no manufacturing activity in the border area.

C. Infrastructure and Basic Services

1. Power Supply

5.10 Given the obstacles which presently impede the provision of adequate, affordable and reliable power throughout Belize, the opportunity for an alternative electricity source at Santa Elena is one of the primary factors behind its consideration as a free zone location. The possibility exists for the transmission of electricity directly from Mexico, across the border to the proposed zone site. At present, there is a power line entering Belize from a power station in Chetumal, Mexico, approximately 6 miles from the

border. This line services the border inspection station, several small commercial operations and the residences of the customs personnel, as well as the Mexican towns between the two points. The capacity of the existing line serving Santa Elena is 500 kilowatts, with a peak demand of 300 kilowatts. Of the remaining 200 kilowatts, 125 kilowatts of the excess capacity would be available for the free zone.

5.11 It is important to note, that the reduction in cost for power sourced directly from Mexico is substantial, and that Mexican electricity is more reliable than that available in Belize. Recent discussions held with Belizean and Mexican officials have indicated that provisions could be made at the zone site to offer electricity at rates ranging from of US\$.10/kwh to US\$.15/kwh, far below the present cost. While the positions of both the Belize and Mexican governments regarding a power agreement are not yet finalized, it is clear that considerable interest exists in the project. Mexico is ready and willing to supply the power to BEB, who would then determine their rates for the Santa Elena site. Under an agreement signed in the 1970s, the purchase price for electricity from Mexico using the existing line is US\$.07 - \$.08 per kwh.

5.12 For the purposes of this report, the most important consideration to bear in mind is that the opportunity exists for accessing additional Mexican-generated electricity in Santa Elena, and the Government of Mexico has agreed in principle to supply the power necessary for the project. Moreover, Mexico has prepared and submitted two concrete proposals to BEB regarding the supply of electricity: (i) a plan to provide electricity for the entire northern region of Belize, encompassing the Corozal and Orange Walk districts; and (ii) a more ambitious plan to install a higher capacity line, which although originally servicing the northern region, could be extended in the future to Belize City. If the free zone area alone is to be serviced, the cost of installation of the line would be substantially reduced. However, the rate charged by Mexico for the electricity could increase.

5.13 It is extremely unlikely that the BEB will be able to reduce the overall national power rates under the existing sourcing arrangements, since the present cost to the BEB is US\$.15 per kwh. Cheap, reliable electricity from Mexico would be an extremely important, unique contribution to the marketability of the Santa Elena free zone project. However, it is doubtful that the existing line can be upgraded to service the zone site, necessitating the construction of a new 2.5 mile, 34.5 kilovolt line from the Mexican substation. Pole transformers at factory sites would be utilized for individual power hookups. Under this scenario, we estimate that line capacity at the zone site of 1.5 to 2.0 megawatts would be sufficient for the first 20-acre development when fully occupied.

5.14 The cost for a new line to the Belize border has been estimated at US\$ 70,000, with an additional US\$ 30,000 expense for the installation of the on-site system. The BEB has suggested that this cost be assumed by the developer of the project. It is the opinion of the project team that if the ownership of the line will revert to the BEB at some future date, a suitable amortization of the developer's original investment must be arranged. BEB would then provide maintenance on the line and handle collections for energy charges. Concessional rates would be available to zone users, with estimates ranging from US\$ 0.10-.15. Moreover, the zone would be guaranteed a reliable power supply, a factor presently not available in Belize at any price.

(There is simply not much excess power capacity in Belize, nor will there be any significant change in this situation over the near term. In addition, the high import duty on fuel makes self-generating just as expensive as accessing the public power supply.)

2. Water Supply

5.15 The site is located alongside a fresh water lagoon and a large river which together can handle any projections of industrial water needs. Well water appears to be the most practical source of potable water. Full investigations regarding water provision will need to be undertaken in order to determine the relative advantages of the alternative sources.

3. Sewage Treatment

5.16 Free zones, as for any industrial estate project, must provide facilities to handle two types of liquid waste -- industrial and sanitary. Where the industrial waste is "benign" -- typical of light non-chemical processing and service industries -- it can normally be mixed with sanitary waste and run into septic tanks associated with each factory. Even if the project were to attract a few factories generating "aggressive" waste materials (acids, alkalis, heavy metal salts, etc.), this approach would be feasible since such operations would be required to pretreat and/or neutralize the waste outflow before it enters the septic tank. This first approach, however, may not be feasible for another reason, i.e., the high water table and the nature of the soil.

5.17 It may be necessary to adopt an alternative and more costly approach -- a central treatment plant and collection system with the final effluent discharged to the river. The details of such a system would be defined in the future feasibility study. Meanwhile, for purposes of cost-estimating we have included a reasonable allowance for this central facility.

4. Telecommunications

5.18 The sparse population in the northern area of Belize and the low level of demand for telephone service has subjected area residents to extremely high charges for phone service, as discussed in an earlier section. Given this situation, the BTA plans to install a Private Branch Exchange System (PBX) in 1986 to service the Corozal area. Under this plan, eight lines would be installed with 32 extensions. All incoming calls would thus be routed through a central system with auto access available for dialing out. Under this scenario, two options exist for the free zone: 1) each zone occupant could separately apply for an extension, and thus be billed separately for phone service, or 2) the zone management could apply for a line, and "distribute" extensions to the zone businesses, with a centralized billing system for the zone. The basic rate for this type of service would be equal to that in Belize City, US\$5/month.

5.19 It appears that the present BTA communications development plan is inadequate, given the incremental increase in demand which will be generated by the zone project. One possible solution is the installation of individual

excellent way in which to utilize the natural resources of the country in the manufacturing process. The production of jellies, jams, chutney, juice concentrate, nut butters, syrups, etc., presents a viable industrial potential for the zone project.

5.24 However, the constraints inherent in the location -- primarily, distance from the port and airport, the high cost of land transport, and an expensive and inadequate communications system will inhibit the attractiveness of the zone for some industries. Additional investigations will have to be conducted to determine the precise sectors to target. As discussed in a later section, Belize may derive optimal benefit from the designation of multiple zones.

F. Preliminary Capital Cost Estimates

5.25 The analysis and conclusions given in this section are obviously preliminary and very approximate. An "accurate" (range of error 10-15 percent) cost estimate can only be derived from a project Master Plan. Such a plan and accompanying technical specifications, in turn, depend on a prior market survey and demand forecast in order to establish a rational basis for predicting the types and sizes of facilities needed. These investigations, however, will not be carried out until such time as a full feasibility analysis is undertaken. In this report, therefore, we base our analysis and conclusions partly on the limited data collection during the field mission and partly on experience and judgement.

1. Land and Land Development

5.26 Among international lending institutions involved in financing industrial estate/free zone (IE/FZ) projects, it is generally recognized that there is a minimum size below which it becomes progressively more difficult to operate on a financially viable basis. In small third world countries, based on project experience in many locations, this threshold may be set at 20-25 acres. This does not mean that the full 20-25 acre area must be developed and fully occupied at once. Rather there should be a reasonable expectation that over the course of 8 to 12 years, effective demand for facilities will justify a phased plan for construction culminating in the full development and occupancy of the site.

5.27 For Santa Elena, we visualize a Phase I development of 10 acres (about 440,000 sq.ft.) which would be able to accommodate shell buildings for warehousing, light manufacturing and service industries with a total "under-roof" rentable area of 176,000 sq.ft. These structures would stand on industrial plots totalling 350,000 sq.ft., leaving 90,000 sq.ft. (of the original 10-acre parcel) available for roads, easements, administration buildings and some green areas.

5.28 During the planning phase -- feasibility study and later architectural/engineering design -- a master plan should be developed for 20 acres. (This is a tentative figure which assumes that demand will, in fact, be projected at a level requiring at least 20 acres or 350,000 sq.ft. of rentable building space over 8-12 years of operations.) For cost estimating purposes, we assume that all 20 acres will be cleared and graded but the

roads, power, water and sewage facilities will be installed only in the 10 acres earmarked for development in Phase I.

5.29 Future phases will depend on market potential realization or effective demand. As the Phase I space becomes occupied, there will be a point in time when the need for additional facilities within a well-defined time horizon will become obvious. Whether the Phase II project develops 5 acres, 10 acres, or more will depend on demand growth and available finance.

5.30 Land preparation costs -- including clearing, grading, etc. -- will likely not exceed US\$0.50/sq.ft., and may be much lower. Also, reportedly, subsoil conditions do not present any problems affecting future costs of excavation, building foundations, etc. Land acquisition cost, at \$30-50/acre, is so low that it can be disregarded for purposes of cost estimating.

2. Infrastructure

5.31 In this report, the term "infrastructure" covers roads, storm water drainage, utility services such as electric power, water, sewage disposal and telecommunications and perimeter fencing. Installations outside the project site boundary are called "external infrastructure" and are generally provided by the relevant public utilities for their own accounts. By the same token, internal (on-site) infrastructure costs are generally chargeable to the project owner. Often, an electric utility will not only bring power to a project, including the transformer substation, but also install and maintain the entire on-site power distribution network. Costs are recovered out of one-shot installation fees and ongoing power consumption billing. On the other hand, it is sometimes necessary for a project owner to finance external infrastructure. This is the case at Santa Elena where an adequate power supply depends on a project investment of US\$ 100,000 and potable water will be obtained from wells (on-site or nearby) developed by the project.

5.32 Data derived from a large sample of IE/FZ projects already built in the Caribbean region indicate that the total cost of land development and infrastructure, in aggregate, normally ranges between US\$ 1.50 - 3.00/sq.ft. of rentable land (i.e. industrial plots). Under exceptional circumstances -- such as when a swampy area must be filled and compacted or a sharply sloping rocky area must be levelled -- the unit cost could be higher. At Santa Elena, subject to more rigorous investigation, there do not appear to be any special problems although a subsoil investigation should certainly be undertaken at the appropriate time.

5.33 For purposes of cost estimating, we have assumed US\$ 2.50 per square foot of rentable land, conservatively, to cover all land development and infrastructure costs. Detailed analysis at the time of feasibility study investigations might result in a lower figure.

3. Superstructure

5.34 To accommodate the activities outlined in paras. 5.22/5.23 as potentially feasible for zone operation, we visualize the structures for the Phase I plan of development as tabulated on the following page:

PHASE I DEVELOPMENT

<u>ITEM</u>	<u>AREA</u> (sq.ft.)	<u>UNIT COST</u> (US\$/sq.ft.)	<u>TOTAL COST</u> (US\$)
1. <u>Administration Building</u> - providing space for Developer's management/operational personnel plus office/service industry space for 3-4 companies	6,000	35	210,000
2. <u>Standard Factory Buildings</u> - suitable for warehouses or light manufacturing operations	170,000	24	4,080,000
	-----	--	-----
TOTAL	176,000	--	4,290,000

5.35 Obviously, the actual construction schedule can be modified, i.e., the first building construction contract can be let for a portion of the buildings, depending on realistic assessment of the initial demand. Considering economics of scale, however, the initial construction contract should be for at least 60-80,000 sq.ft. of SFB "under-roof" space. If initial demand is, in fact, projected at lower than 30-40,000 sq.ft. (which would justify a civil works contract for at least 60,000 sq.ft.) project feasibility would have to be deemed questionable.

5.36 The tabulation above is based on a building module of 6,000 sq.ft. (A 10,000 sq.ft. module may be more efficient in Belize; this issue can be addressed in the future.) Implicitly, the administrative staff would occupy a part of one SFB (say, about 1,500 - 2,000 sq.ft.) leaving most of the space for other office-type activities requiring rented space of higher specifications than in the SFBs earmarked for light industry. Two or more modules could, of course, be leased by a company requiring 12,000 or more square feet. It is too early to give exact specifications, but SFBs typically can be steel-frame on reinforced concrete floor slabs with gabled roof or entirely reinforced concrete construction with flat roof slab carried on columns, also of reinforced concrete. Generally, the clear height under roof trusses or at the eave (if A-frames are used) is about 16-18 ft., permitting a mezzanine level over part of the floor slab, if needed.

5.37 Installed costs for the types of building construction described may range from US\$ 20-30/sq.ft. for SFBs as factories and US\$ 30-40/sq.ft. for SFBs of somewhat higher spec for office use. The project team estimated that at Santa Elena, building costs would be about as shown in the tabulation, para. 5.34.

4. Summarized Cost Estimate

5.38 In view of the uncertainties related to future demand and project size, the capital cost estimate presented below reflects the base project described in earlier paragraphs. This is followed by two alternative estimates -- one "optimistic," which assumes the full 20-acre site development over eight years, and the second "pessimistic" which assumes the absolute minimum facility discussed in para. 5.35.

PHASE I-- BASE PROJECT

Assumptions: twenty acres of land cleared; 10 acres graded, complete with access road, internal roads, storm drainage, all utilities installed and connected to buildings:

	<u>Capital Investment</u> (US\$)
Land Acquisition (20 acres)	---
Land Development (10 acres)	875,000
Buildings (176,000 sq.ft.)	4,290,000
Preliminary Costs Capitalized	250,000
Architecture/Engineering Design and Supervision	200,000
	<hr/>
Sub-Total	5,615,000
Contingencies (15%)	842,250
	<hr/>
TOTAL	6,457,250
	<hr/>
ROUNDED TO:	\$6,500,000
	<hr/> <hr/>

Note: All estimates are in 1986 constant prices. Future analysis will adjust for anticipated inflation.

5.39 Optimistically, effective demand during the early years of the project might indicate the need to develop the full 20-acre site over an 8-year time span. Additional investment would amount to about US\$ 5 million to double the rentable area. Unit cost, of course drops since a portion of the infrastructure and certain other costs would have already been charged to the Base Project.

5.40 Pessimistically, projected demand drops to a level that can justify only a minimum SFB construction of 60,000 sq.ft. Capital requirements would then drop to about US\$ 3.2 million. Unit cost is higher and this minimum project would be marginally profitable, at best.

VI. OWNERSHIP STRUCTURE AND FINANCIAL CONSIDERATIONS

A. Public/Private Options in Free Zone Development

1. Overview

6.01 From a financial perspective, a free zone is essentially a real estate development consisting of an export-oriented industrial area under the proprietary control of a public agency or private corporation, henceforth referred to as the "Project Developer." The agency will generally plan, develop and manage the project - as a profit or non-profit entity - and promote the sale or lease of land, buildings and services to industrial firms.

6.02 For implementation of a free zone project in one or more locations in Belize, financing will be required to meet initial capital investment and operating costs until the project becomes financially self sustaining. Phase I capital costs associated with the physical development of the zone have been estimated at US\$ 6.5 million, including the following:

- a. Land acquisition;
- b. Infrastructure, including the installation of facilities for electricity, water, sewage treatment, telecommunications and transportation facilities, including access and internal roads and possibly port and airport improvements; and
- c. Superstructure, including the construction of industrial buildings and business and commercial services such as canteens, restaurants, training centers, etc.

6.03 Operating costs consist of personnel, office and associated overhead expenses for project management and marketing, travel and other direct expenses for investment promotion missions, maintenance and insurance of free zone facilities, depreciation and interest expense. During the construction period, operating expenses are generally capitalized. Thereafter, gross income should be sufficient to meet current obligations.

6.04 Financial services are often made available to zone industries by developers, depending upon the needs of zone users and the structure and capability of the zone operator. In association with commercial or development banks, or as a separate operating entity, free zone corporations such as the Shannon Industrial Development Corporation have provided loans to zone industries. Other agencies, such as the Puerto Rico International Distribution and Free Zone, Inc. have endeavored to assist zone industries in accessing funds through private and public channels. These financial services are generally offered to provide additional incentives to industry as well as individual profit centers.

6.05 Project financing can be obtained from a number of different sources, depending upon the size of the project, profitability and project risk, and the ownership and management structure of the free zone company. The following sections will review the available ownership options and discuss their financial performance based on project experience in other countries.

2. Ownership Options

6.06 Three options exist for ownership of free zone facilities in Belize:

(a) Public Sector Ownership by an executing agency designated by the GOB with 100 percent control for zone development, ownership, and operations. Facilities would be leased or sold mainly to the private sector. Typical executing agencies include: Ministry of Industry, development banks, autonomous public sector corporations and port authorities.

(b) Public/Private Joint Venture for zone development could take a number of different forms, but the most common would be for the GOB to contribute land and infrastructure as equity in a joint venture company. In this instance, the private sector's contribution to the project would cover land development, buildings, management and services.

(c) 100 Percent Private Ownership and Development including private financing, provision and management of land, buildings and associated infrastructure.

Private participation in options (b) and (c) can be undertaken either by indigenous or foreign investors, alone or in partnership. The nature of private sector involvement in the project, of course, will be heavily influenced by the financial merits and general policy framework established by the GOB for zone development.

6.07 These basic ownership alternatives have been employed, in varying forms, in free zone development around the world. The relative merits and disadvantages of each inevitably are reflected in performance and financial results. In general, public sector zones are plagued by unresponsive management, overstaffing and politically motivated turnover of personnel. The political pressures which operate on the public sector have often resulted in decision making which reflects the necessity of appeasing a narrow constituency or interest group, rather than effective, businesslike goal-oriented management. As stated earlier, often publicly owned zones are operated as loss leaders, featuring subsidized rental of industrial facilities. Such an arrangement not only produces unfair competition to the private, unsubsidized investors, but foregoes financial benefits that might just as easily have been realized. Public sector zones rarely show a profit, although in those cases where an autonomous corporation is established to operate a zone (e.g. Singapore; Kingston, Jamaica; and Shannon, Ireland), financial performance has been better than in other governmental operations. However, even in these instances, the results have been below what could be expected of projects under private sector control.

6.08 Joint venture arrangements between public and private partners have fared much better than publicly owned zones. As indicated above, government involvement may be limited to the provision of land in return for equity shareholding with the private sector holding the responsibility for development, management and servicing of the zone. The benefits to be derived from this arrangement include an assumed complementarity of interest

between the two partners, that is, favorable public policy decisions regarding the zone are more likely, as is responsible management of the zone on the part of the private investor. However, in some cases, private firms have been reluctant to enter into business agreements with a sovereign entity. This hesitancy is especially apparent in countries where changes in government are an ever-present threat. Moreover, instances of conflict of interest may arise for government leaders on those issues which have a bearing on zone performance.

6.09 In general, experience has demonstrated that it is the 100-percent privately owned zones, operating within reasonable, established public policy guidelines which have demonstrated the most success. The government's role in the project is to design an attractive regulatory framework for zone development and operation which also safeguards and promotes the public interest. The private sector, on the other hand, is given the freedom to operate as it sees fit, maximizing profits and thus elevating the benefits to the local and national community. This clear division in responsibility ensures objectivity on the part of the government and encourages the profitability of the zone.

3. Financial Performance of Free Zones

6.10 For both publicly and privately developed free zones, financial performance is determined by the relationship between costs and revenues. Assuming reasonable operating costs, the financial return is a function of prices charged for industrial space and services which, on the one hand, must be market-place competitive and, on the other, must cover all costs and yield a profit. Financially successful projects invariably reflect these pricing policies. Under such conditions, the enterprise is assured of financial independence and bankable status in financing growth.

6.11 Cost recovery in free zone projects sponsored by the public sector is rare. A study of free zone contributions to economic development conducted by FZA in 1984 analyzed the financial return on investment of 13 public sector projects world wide./1 The results of this analysis revealed that of the 13 free zone projects analyzed, only two (in Taiwan and Malaysia) were operating on a cost recovery basis. Typically, public sector project management regards profitability as a secondary objective and pricing policies reflect varying levels of subsidy./2 The rationale behind this approach is that reduced prices for free zone facilities are necessary to attract investors and that the long-term economic benefits will exceed financial losses. In all the free zones offering subsidized facilities, periodic "calls" on the national treasury have been necessary to keep the projects afloat. In most LDCs, the merits of this repetitive injection of public funds are questionable, given that the beneficiaries are, for the most part, profitable industrial enterprises fully capable of paying economic prices for facilities.

/1 Export Processing: Zone Contributions to Development, Free Zone Authority Services, June 15, 1984.

/2 The Ladyville Industrial Estate in Belize is one example of a public sector project with a subsidized pricing policy.

6.12 The fact that the private sector, motivated by profit-oriented objectives, has successfully developed free zones on a full cost recovery basis in at least eight developing countries supports the idea that economic pricing is feasible. In Mexico, for example, there are private projects established alongside the U.S.- Mexican border which operate in close proximity to government-owned facilities. The private zones demand and receive higher prices (up to 40 percent), while the subsidized government facilities continue to operate at a loss. Other profitable privately owned zones have been established in the Dominican Republic, Costa Rica, Mauritius, Malaysia and in some of the smaller islands in the Eastern Caribbean.

6.13 In all of these instances, the government has been able to realize the economic benefits associated with free zone development, including job creation, foreign exchange earnings, technology transfer, etc., without incurring the financial burden. However, careful coordination between the private developer and relevant public sector institutions must be maintained to assure that the project fulfills the objectives of the government while generating profits for the owners.

6.14 To date, interest in developing a free zone in Belize has been expressed by at least four corporations. This unsolicited interest provides a clear indication that there could be a significant role for the private sector. There also appears to be a consensus within the GOB that the role of the public sector should be held to a minimum.^{/1} In light of the generally poor performance of public sector projects, it is the consultants' opinion that private sector involvement with public sector support would result in accelerated development of the project, improved financial cost/benefit ratios and increased economic benefits for the country. However, successful implementation of the project will require from the government, the development of a strategy including: the development of an effective institutional and legal structure; consensus on the role of the private sector; development of incentives; streamlining of regulatory procedures, establishing realistic performance requirements; efficient planning, pre-investment project analysis and project execution. Finally, once the facility becomes operational, given the level of regional competition, a strong, sustained and adequately funded international marketing/promotional effort will be essential.

B. Financial Requirements

1. Factors Affecting Profitability

6.15 There are two main sources of profit for developers (either public or private agencies) of free zone projects: (i) land speculation leading to capital gains; and (ii) revenue from factory space and services leased or sold to occupants. Land speculation, defined in this context as the acquisition of undeveloped or developed land for the purpose or resale with or without improvements, is not appropriate at the present time in the

^{/1} Within the government of Belize, a number of officials have expressed support for private sector involvement in the project, including the Governor of the Central Bank of Belize and the Prime Minister.

Belizean context. In addition to government policy which discourages land speculation, current market conditions do not encourage activity. The surplus of industrial land and the refusal, in most cases, to accept land as collateral has served to keep land prices at a minimum resulting in extremely weak market conditions.

6.16 The second source of profits for industrial developers is the rental income from factory space and services or the income derived from the sale of industrial plots and facilities. Gross income will, of course, be determined by the demand for, and market value of, free zone facilities. This figure reflects the competitive position of Belize vis a vis other production centers within the country and the region, the cost of inputs, investment incentives and the terms and conditions of finance. Some of these considerations are external, i.e., they cannot be directly controlled by the developer. Other factors, however, are questions of government policy as discussed below.

a. Competition

6.17 A free zone project in Belize will face competition from neighboring countries as well as other LDCs vying for the same investment dollars. As discussed in Chapter 3 of this report, potential competitors include, Barbados, Dominican Republic, Mexico, Costa Rica and the Eastern Caribbean. All of these countries, with the exception of the small islands of the Eastern Caribbean, are charging more or less economic rentals, i.e., US\$ 3.00 - 5.00/sq.ft./year. All other factors remaining equal, the project in Belize should be able to attract occupants at economic or market rates if the public sector agencies involved with industrial development resist the temptation to offer comparable facilities at highly subsidized prices in other locations in Belize./1

6.18 In order to eliminate the threat of "unfair" competition from subsidized facilities provided by the public sector, some potential private developers have requested "exclusivity agreements" for free zone development. In other words, private developers have requested protection from government intervention in the market as well as a guaranteed monopoly for free zones in the country. It is the opinion of the consultants that exclusivity as it relates to "unfair competition" from the public sector is a reasonable request. The private sector, clearly motivated by profit objectives, is not in a position to offer subsidies on a politically determined basis. Exclusivity as it relates to protection against competitive projects, however, may not serve the economic objectives of the GOB's industrial development strategy. A monopoly position, whether public or private,

/1 It would appear that the Ladyville Industrial Estate does not present direct competition to the proposed free zone project at the present time. Although rental rates are less than market value at \$1.50 per sq. ft., the buildings are poorly maintained and services are less than adequate. However, if the DFC decides to draw down additional funds from the CDB, and estate management and maintenance is improved, an economic pricing structure should be adopted to reduce the financial losses of the project and eliminate unfair competition with the free zone project.

tends to create artificial shortages in order to increase prices and may serve to discourage investment.

6.19 In summation, private sector development of a free zone project will be difficult to implement without an adequate policy framework for designating, approving and regulating free zone projects, and guarantees against competition from government subsidized facilities. Without a consistent policy, private sector development may not occur in a manner conducive to industrial growth.

b. Inputs

6.20 In order to maintain a competitive position within the market, the developer has to keep the cost of inputs at the minimum level necessary to assure a quality product. The major inputs for free zone development consist of the land, buildings and services including road construction materials and the incremental investment required to assure adequate electricity, water, telecommunications and sewerage facilities. These inputs, particularly construction materials and specialized utility equipment, should be procured at world market or border prices and not be subject to taxes or tariffs in Belize. Note that the Belize Fiscal Incentive Ordinance does not expressly exclude construction materials and other inputs required in zone development from import duties. A change in policy may be required to promote both free zone development as well as creation and expansion of individually owned manufacturing facilities.

6.21 Building design requirements, and engineering and architectural fees, can also increase costs. For some public sector free zone projects, construction costs have been 20 - 40 percent higher than for private zones with comparable structures due to "over designed" facilities and mandatory engineering and architectural requirements. In most instances, the lenders (specifically the Caribbean Development Bank or the World Bank) specify standards which must be followed. Commercial banks, on the other hand, do not generally specify design requirements. Clearly, unnecessary regulations imposed by the planning authorities should be avoided and building permit procedures simplified to the extent possible.

6.22 The provision of services, including electricity, telecommunications, and water and sewerage to the free zone site has generally been the responsibility of the relevant government agencies. However, in recent times, there has been a notable shift to the private provision of services. For example, in Jamaica, specialized external telecommunications will be provided by a private company through a teleport facility. In the Dominican Republic and the Eastern Caribbean, electricity services are often provided by small generators owned by the manufacturer or zone developer. Transportation services for the workers are also provided by private bus companies throughout the Caribbean and Far East free zones. In most instances the developer will contract out these services to qualified firms.

6.23 During the project identification mission, the consultants identified potential bottlenecks in the provision of electricity, telecommunications, water, sewerage and transportation, as is discussed in detail in Chapter 6. Most of these services are carried out by monopoly parastatal corporations in Belize, and, it is evident that the suppliers are not currently in a position

to meet the potential demand of the proposed free zone project at Santa Elena. The provision of electricity, for example, may require an investment of US\$100,000 to bring power to the site of the proposed project.

6.24 These costs are normally amortized over time by the developer through rental revenue and/or the sale of land and facilities. However, in the event that the initial development costs are high, as is the case at Santa Elena, user charges will also be high, potentially above market rates. Various options, including the private provision of services within the zone, contracting out the delivery of services, or separate pricing schemes should be explored to mitigate the high development costs.

c. Investment Incentives

6.25 Investment incentives, such as income tax holidays, guaranteed repatriation of capital investment and profits, and exemptions from taxes on dividends paid from profits are normally not required if the free zone project is a publicly owned corporation. As a parastatal, most free zone corporations are normally exempt from income and other taxes, but may pay dividends to the government in the event of a profit. Alternatively, some publicly owned free zones use their cash surplus for expansion of the project.

6.26 In order to attract private capital for free zone development, however, investment incentives may be a necessary (but not sufficient) condition. Private investors will generally seek a return on investment of approximately 20 percent per year or more, given the level of risk involved in an offshore development. Without tax exemptions for a period of approximately 10 years, this return may be difficult to attain given the project development costs and present market value of zone facilities.

6.27 Investment incentives, which are regulated by the Development Incentives and Fiscal Incentives Ordinance, Chapters 40 & 45, of the Laws of Belize (1980), do not specifically include concessions to free zone developers. The degree to which legislation may have to be amended has not been determined, but the authorities should recognize that granting incentives would not represent revenue foregone to the government. As previously stated, publicly owned free zones generally operate at a deficit, or, in the event of a positive rate of return on investment, dividends are rarely paid.

d. Terms and Conditions of Finance

6.28 Some free zone projects, such as Montego Bay, Jamaica; Puerto Plata, Dominican Republic; and Cassada Gardens, Antigua have failed to maximize their financial and economic return due to the lack of available finance at reasonable terms and conditions. In each of these projects, the developers were unable to meet the demand for free zone facilities in a timely manner due to inadequate financing mechanisms.

6.29 Although free zones are generally developed in phases to ensure that the supply of facilities reflects demand, financing secured for the initial project development should carry some commitment of funding availability for

future expansion. Demand forecasting is an inexact "science" and the project developer must be prepared and able to respond to unexpected surges in investor interest in a timely manner. In today's competition to attract foreign investment, experience indicates that most potential investors will not wait a year or more for a developer to secure finance for factory space -- in many instances, they will invest their money in another locations.

6.30 Free zone projects generally require long-term finance (i.e., a repayment period of more than 10 years) to ensure that gross income is sufficient to cover all operating costs, including debt service. Interest rates should correspond to US prime rates, or slightly above in order to ensure project profitability. Loans are normally denominated in US dollars in order to procure imported raw materials required for construction. Similarly, rental rates or sales agreements are generally specified and collected in US dollars or equivalent in local currency to eliminate any foreign exchange risk.

2. Potential Sources of Finance

6.31 In the Caribbean/Central America region most publicly owned free zone projects have been financed by either the Caribbean Development Bank, the World Bank or internally generated public funds. For private zone development, a number of sources have been used including (i) commercial bank financing with equity contributions from the developers; (ii) discount facilities provided by US AID; and (iii) in some instances, government grants combined with private capital. As a result of the emphasis on private sector development, the following section reviews the available sources of finance and terms and conditions for privately owned projects. A review of available public sector sources is provided in Annex 2.

a. International Commercial and Investment Banking Institutions

6.32 Mobilizing long-term capital through international commercial and investment banking institutions will depend upon a number of different factors, including (i) creditworthiness of the borrower; (ii) loan security; and (iii) minimization of risk.^{/1} Based on informal discussions with financial institutions and previous experience in free zone financing, mobilizing capital abroad may be possible for large real estate developers with substantial investments in North America or Europe. A smaller developer may be able to tap this source of finance if a strong anchor tenant, such as a Fortune 500 company or similar corporation was prepared to make a commitment to lease or purchase space in the project. Alternatively, an individual investor or smaller development company may be able to borrow on the international markets if he is prepared to provide sufficient collateral

^{/1} Since deregulation of the banking system in the United States, many commercial banks have gained investment banking capabilities. For purposes of this discussion, the distinction between deposit taking institutions and investment banks is not important. In addition, a discussion of borrowing on the Euro-Currency markets has been omitted due to the relatively small size of the project and need for long-term finance.

(such as real assets in the United States) to cover the debt. Furthermore, in the event that none of these conditions is satisfied, the financial institution may require a government guarantee to minimize risk.

6.33 It is too early in the project development stage to assess whether one or all of the above conditions can be satisfied. Although potential tenants for the free zone have been identified by organizations such as BEIPU, it may not be conceivable to enter into negotiations until the feasibility of the project has been assessed and the GOB has articulated policy guidelines for private sector involvement.

b. Local Commercial Banking Institutions

6.34 Free zone and industrial park developers throughout the developing world have often relied upon the local commercial banking system to provide the debt portion of project finance. For zone development in Belize, however, this may not constitute a viable option. In addition to those factors considered by the international commercial lenders for project finance, the local commercial banking sector is constrained by the lack of long-term funds and their internal procedures are not conducive to long-term lending.

6.35 The commercial banks, consisting of branches of three major international commercial banks and one indigenous institution, are the main holders of the financial assets of the economy./1 The banks generally provide overdraft facilities and short-term loans to the private sector. In general, the commercial banks' approach to lending can be characterized as excessively restrictive as evidenced by their security requirements and the necessary track record of the borrower. Moreover, mortgage lending is almost non-existent, due to the lack of internally generated long-term funds available for on-lending and unwillingness to lend long term resulting from the perceived instability in the investment climate. In 1984, for example, the commercial banks' outstanding loans for building construction stood at less than BZ\$15 million, which included both mortgage loans and short-term construction financing./2

6.36 Recognizing this gap in the financial sector, US AID established a discount facility through the Central Bank of Belize for on-lending to commercial banks. A total of US\$5 million was allocated in 1984, of which less than US\$1 million has been committed. As part of the terms of reference for this paper, the applicability of this facility to the free zone project was examined.

/1 An additional indigenous bank, the Belize Bank of Commerce and Industry has recently been granted a license to operate in the country. As of June 1986, the bank had not begun operations due to prolonged negotiations to buy the Belize branch of the Royal Bank of Canada. In the event that this purchase is successfully completed, expectations are that BCCI may provide medium- to long-term project finance.

/2 A Study of the Financial System of Belize, by Jalil Shoraka for Arthur Young & Company, July, 1986.

6.37 During the past three years, US AID has attempted to use the discount mechanism (either through local counterpart funds generated by PL480 programs or Development Assistance Funds) in other parts of the Caribbean for free zone or industrial park development. The Infrastructure for Productive Investment Project (IPIP), for example, was established as a discount facility through the Eastern Caribbean Central Bank (ECCB) for industrial facilities development in January 1985.^{/1} A total of US\$ 12 million was allocated to the project and was expected to be fully committed by 1988. To date, less than US\$ 1 million has been disbursed from the ECCB. This lack of activity can be attributed to a number of different factors, including the lack of sufficient incentives to the commercial banks, reluctance to lend long term for relatively high risk projects, unfair competition from the governments within the Eastern Caribbean, and a decrease in demand for factory space.

6.38 Similarly, a US AID sponsored project in the Dominican Republic to provide finance for free zone development has encountered problems. The commercial banks have been reluctant to on-lend long-term funds to the developers despite very strong demand for space within the free zone. Also, the commercial banks have been reluctant to lend more than US\$1 million to any one project due to perceived "overexposure" to one client in one specific sector. As a result, zone developers have used other non-conventional mechanisms for finance.

6.39 In summation, it is the consultants' opinion that the commercial banks presently operating in Belize (through external sources such as the discount facility or with internally generated funds) may not be able to provide the financial requirements of the project. However, a role may exist for the commercial banks in providing overdraft and short-term loans to zone industries. In some instances, foreign manufacturers prefer to work in a joint venture with local entrepreneurs. Throughout the Far East, and some countries in the Caribbean, foreign manufacturers subcontract their production to local firms. The foreign party generally provides the overseas marketing arrangements, technical assistance and possibly financing for operations and the local partner generally manages the production facility. Although the export manufacturing sector in Belize is relatively underdeveloped, the free zone project could provide a stimulus for growth. In addition to technical assistance which could be provided through the US AID Training for Employment Project, short and medium term capital (including export credits) may be required. Given the commercial banks' lending posture, incentives such as income tax exemption on loans made to local manufacturers operating in the free zone should be explored further.

c. Multilateral and Bilateral Private Sector Lenders

6.40 International financial institutions, such as the International Finance Corporation (IFC, affiliated with the World Bank) and the newly formed InterAmerican Investment Corporation (IIC, affiliated with the InterAmerican

^{/1} US AID provided US\$12 million to the ECCB for on-lending to commercial banks. The ECCB on-lends at 5 percent and the commercial banks provide funds to the end-borrower at 9 percent interest. The EC region includes St. Kitts, Antigua, Dominica, St. Lucia, St. Vincent and Grenada.

Development Bank) are responsible for catalyzing debt and equity capital for the private sector in LDCs without sovereign guarantees. The IFC operates worldwide and has been operational for more than 25 years. The IIC was recently approved by the Board of Directors of the IDB and is expected to be operational within the next 12 to 24 months. The IFC will take lead and risk positions in projects, especially for purposes of promotion. As a general rule, however, the IFC is a minority investor and serves to supplement and attract other capital. IFC's investment is generally limited to 25 percent of the total project needs, and the minimum loan size is US\$5 million, which has been waived in certain instances in the Caribbean region.

6.41 To date, the IFC has not been involved in any free zone projects. Informal discussions with the IFC staff indicate that a free zone project in Belize could be considered for financing if the project is financially profitable and provides significant contributions to the economy.

6.42 In addition to the international financial institutions noted above, bilateral sources of finance, such as the Overseas Private Investment Corporation (OPIC) have expressed an interest in financing free zone development. OPIC is a self-sustaining US government agency whose purpose is to promote economic growth in developing countries by encouraging US private investment in those nations. OPIC assists US investors by (i) providing insurance against certain political risks; and (ii) financing enterprises through direct loans and/or loan guarantees. OPIC financing can be accessed by any corporation which is at least 25 percent owned by a U.S. corporation. Eligibility is determined based on the technical, marketing and financial soundness of the project as well as the applicant's track record in the same or closely related business. Interest rates are generally above prime and a 60:40 debt to equity ratio is generally required./1

6.43 Other bilateral sources, such as the US AID revolving fund, may also be available for project finance. Depending upon the donor country, each facility will have specific procurement requirements and restrictions which may not be suitable for free zone projects. Similar to the multilateral lending agencies, a potential borrower will encounter a long lead-time for project development and evaluation.

6.44 Although the financial options examined above do not, by any means, represent an exhaustive list of potential sources of finance, they indicate that funds could be secured for the project if the GOB creates a policy environment conducive to private sector development and the full feasibility analysis shows sufficient demand for a zone services./2

/1 During recent discussions with staff members of OPIC, the finance department indicated a willingness to entertain proposals for a free zone project in Belize which may require terms and conditions above the norm.

/2 Another financing option, which is being explored in Costa Rica is a debt/equity swap where the foreign exchange component could be used to purchase Belize public external debt at a discount in a secondary market and then swapped for a domestic currency instrument and converted into BZ dollars.

VII. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

7.01 Free zone development is both feasible and desirable in Belize. A national free zone program will help to achieve numerous economic and social objectives, including:

- * export expansion and increased foreign exchange earnings;
- * employment generation and technology and skill transfer;
- * increased regional and international trade linkages and utilization of the existing preferential market agreements;
- * expansion and diversification of the agricultural sector through the establishment of processing facilities and the attraction of increased investment;
- * increased private sector participation in the financing of national economic development, marketing and promotion.

Specifically, a free zone developed at the Santa Elena site would serve the following purposes:

- * encourage and support transborder commerce between Belize and Mexico;
- * utilize the large existing regional labor supply and serve as a growth pole for the northern districts of Belize;
- * offer a reliable and relatively inexpensive source of power for industrial operations unavailable elsewhere in the country;
- * provide a much needed economic stimulus to the Corozal region which is not subject to the vagaries of the global commodities market, and offers the opportunity for the further diversification of the region's economy.

7.02 It is the opinion of the project team that while the prospects for free zone development in Belize appear to be good, a number of institutional actions will need to be taken in order for a zone program or project to achieve its full potential. Moreover, additional investigation will be required to determine the optimal configuration, institutional and legislative requirements, market orientation(s) and development strategy for the program. The following section contains preliminary recommendations that can be made regarding free zone development in Belize.

B. Recommended Zone Development Characteristics

1. Location(s)

7.03 Development of a free zone in Santa Elena appears to be potentially feasible for certain industrial sectors due to the availability of (relatively) inexpensive electricity and an abundant Belizean labor supply which can be supplemented by Mexican workers, if necessary. The primary limiting factor at Santa Elena is the absence of industrial transportation facilities, particularly access to an international port and airport.

7.04 Free zone legislation should provide for the multiple siting of free zones, that is, individually designated factories as well as additional zone locations. Certain industries, particularly agro-industry, require processing facilities located adjacent to the source of production. These industries could benefit from free zone status if local resources are combined with imported goods for further processing before export.

2. Market Orientation

7.05 Although a market survey has not been undertaken, it is the consultants' opinion that the following sectors hold high potential for establishment in a free zone in Belize:

- * Manufacturers located in Mexico which can produce in Belize to meet the 35 percent value-added requirements for duty-free access to the U.S. market under the Caribbean Basin Initiative;
- * Domestic and foreign manufacturers wishing to access preferential trading arrangements under the Lome Convention, CBI, Caricom, TSUS 806/7, and other agreements available in Belize;
- * Warehousing and transshipment businesses serving Belize and Central America as well as firms which provide specialized facilities for the agricultural sector;
- * Light manufacturing industries, including garment manufacturing, electronic assembly, toys and sporting goods, and possibly data processing; and
- * Agro-industrial operations which utilize domestic raw materials and imported packaging materials, glassware, etc., in the preparation of processed foods.

3. Ownership and Management

7.06 Based on the poor performance of public sector free zones worldwide and the demonstrated interest by the private sector in developing a zone project(s) in Belize, it is recommended that the public sector assume a supportive and regulatory function rather than an active role in project development. A policy environment conducive to private sector ownership and management should be developed through legislative and institutional support, including:

- * Guarantees against "unfair" competition from government subsidized projects of similar quality;
- * In order to avoid a private monopoly and encourage competition, exclusive rights for free zone development should not be granted to any one developer; and
- * Automatic incentives to developers, including income, property and local tax exemptions, guaranteed repatriation of capital and profits, and exemption from import duties for materials used in zone development.

7.07 In order to increase the potential for a profitable project and deliver services at rates competitive with other zones in the region, it is recommended that the GOB explore ways to allow the private delivery of services within the zone, including electricity, specialized telecommunications (i.e., teleport facilities), and transportation.

4. Financial Considerations

7.08 A number of sources exist for financing private free zone development, including the International Finance Corporation, Overseas Private Investment Corporation as well as the international commercial and investment banking institutions, depending upon the profitability and risk of the project. If required by a developer, it is recommended that the government executing agency provide an "information service" to potential developers on sources of finance. Follow-up discussions should also be held with the staff of the IFC and OPIC after a full feasibility analysis has been completed.

7.09 Use of the CBI discount facility for zone development may not be appropriate due to the restrictive practices used by the local commercial banks, including the unwillingness to lend long-term, and perceived risks resulting from overexposure to one individual or company. It is recommended, however, that an analysis of using the discount facility or other US AID-sponsored finance project for zone industries, particularly local manufacturers be undertaken.

5. Physical Development

7.10 Preliminary investigations indicate that a minimum 20-acre area should be designated for the zone at Santa Elena. During the project planning stage, a detailed Master Plan should be undertaken for the designated area.

7.11 During Phase I development, the entire zone area should be cleared and graded and requisite infrastructure installed on a 10-acre portion of the site. Preliminary cost estimates have been drawn up for the construction of 176,000 sq.ft. of buildings in Phase I, if sufficient demand is evidenced for space. Assuming this 10-acre development as the "base project," capital costs for Phase I have been estimated at US\$ 6,500,000. This figure includes the technical assistance, engineering, and design work which is essential to the successful realization of the project.

C. Recommended Institutional Involvement

1. Legislative Structure

7.12 Belize already has a substantial number of investment incentives in place. In contrast to traditional incentives, however, free zones differ in both the manner of their implementation and in their breadth of stimulus. Both distinguishing elements should be addressed directly by Belize's free zone legislation.

7.13 The manner in which incentives are administered is perhaps the most essential prerequisite for success. Export-oriented firms are extremely reluctant to commit to a location in which they perceive that the application of the incentives will be subject to a lengthy, case-by-case negotiation process. Accordingly, the zone legislation should indicate that applicant firms will receive the incentives automatically within a 14-28 day period upon satisfactory completion of a zone user's application form. A "one stop" permit approval center should be established, under BEIPU supervision, to ensure expedited processing of all zone-related applications.

7.14 As noted previously, free zones are also unusual in the comprehensive way in which they reduce impediments to business expansion. The experience of countries with the most successful free zones indicates that Belize's free zone legislation should have the following characteristics:

a) Zone user incentives. The zone legislation should comprehensively remove or reduce government-created constraints on export-oriented private sector firms. Specifically, the legislation should contain the following elements as "automatic" benefits to be administered to zone users:

- tax incentives
 - 100 percent exemption from corporate income taxes for a minimum of 15-20 years
 - exoneration of all taxes on dividends and interest payments
 - relief from sales taxes and excise taxes
 - exemption from local taxes
- regulatory relief measures
 - free foreign exchange convertibility
 - free repatriation of profits, dividends and interest payments
 - liberalized labor code provisions (governing discharge of employees)
 - one-stop permit approvals
- tariff abatements
 - duty-free import of capital goods, intermediate goods, and raw materials to the zone
 - Customs duty payments only on goods shipped from the zone into the domestic economy
- self-provision of infrastructure/basic services
 - within the zone, private providers may supply users with any or all of the following, notwithstanding monopolies outside the zone:

- o roads, port, and airport infrastructure
- o power generation systems
- o telecommunications systems

b) Zone ownership/management. The experience of privately vs. publicly owned and managed zones in Mexico, the Dominican Republic, Bahamas, Mauritius, and Costa Rica shows unequivocally that private zones are far more attractive to zone firms. Profit-oriented zone developers have consistently proven to be more aggressive in marketing their zones and remaining responsive to occupant needs.

c) Zone designation criteria. Several Caribbean Basin countries-- notably the Dominican Republic and Jamaica--at present have far more demand for free zone space than they can accommodate with the supply of factory buildings. In order to avoid similar developments in Belize, the free zone legislation should prevent the artificial restriction of supply, e.g. granting exclusive rights to free zone development in Belize. Further criteria for free zone designation should be determined after a thorough feasibility examination.

d) Private financing incentives for zone developers. To assist zone developers in launching projects without recourse to governmental funding, the free zone legislation should also encourage private financing mechanisms. The following approaches appear to have greatest potential:

- equality of treatment of zone developers with zone occupants (i.e., no corporate taxes, foreign exchange controls on zone earnings, etc.);
- creation of tax-free loan instruments for lenders to collect interest from private zone developers; and
- establishment of firm debt/equity conversion criteria for Central Banks to expedite swaps of external debt for local currency investments in free zones.

2. Executing Agency

7.15 It is suggested that BEIPU form the "Belize Free Zone Corporation" as a limited liability corporation, responsible for acting as a one-stop agency for zone designation, marketing, financing, and supervision. The institution should have the structure and functions outlined on the following page:

BOARD OF DIRECTORS
 (should be private sector-dominated, along with institutions
 such as BEIPU, Customs, Ministry of Commerce and Industry, etc.)

:

MANAGING DIRECTOR

:

MARKETING/ PROMOTION UNIT	RESEARCH/ PUB. INFORMTN UNIT	INTERNAL ADMINISTR'N UNIT	TECHNICAL ASSISTANCE UNIT	FINANCIAL ASSISTANCE UNIT	DESIGNATION/ SUPERVISION UNIT
(follows up BEIPU leads)	(keeps stats, generates publicity)	(maintains internal systems)	(helps w/ feas. studies)	(targets low-int. loans)	(reviews zone developer/ user appli- cations and reports)

7.16 The budget for the executing agency should be made proportional to the success of the free zones that it oversees. Toward this end, Costa Rica has developed an effective financing system: 12 percent of the gross rent charged by any free zone in the country goes to the Corporacion de las Zonas Francas, the government institution supervising the free zone program. This formula can not only ensure financial self-sufficiency for the supervising organization as zones progress, but it creates a useful incentive for the responsible agency to behave in a businesslike rather than bureaucratic manner.

3. Coordination With Private Sector

7.17 In addition to coordinating with private sector developers and zone users as indicated above, the Belize Free Zone Corporation should work actively to create strong linkages between zones and local private enterprises. Such indigenous firms can benefit from successful zones in at least three ways. First, zone occupants will create a number of opportunities for local firms to supply needed goods and services, in fields ranging from provision of raw materials and repair services to building and grounds maintenance, workforce transportation, and security -- and the Belize Free Zone Corporation should aggressively work to acquaint local businesses with such opportunities. Second, local private training institutions should be brought into direct contact with zone occupants, for the purpose of tailoring their curricula to better meet business needs. Finally, successful free zones in many countries create a "demonstration effect" for market-oriented policies, strengthening the hand of liberalizers who favor the extension of such policies to the entire economy. Toward this end, the free zones can be useful proving grounds for streamlined regulatory approval processes and privatization initiatives.

4. Coordination with Other Government Agencies

7.18 The Belize Free Zone Corporation should take the steps necessary to ensure coordination with the Ministry of Commerce, Tourism and Industry, and the Ministry of Finance so that obstacles to free movement of foreign exchange within the zones are removed in practice as well as on paper. Another crucial inter-governmental coordination requirement concerns the relationship between the Belize Free Zone Corporation and the Customs Service. Although interlocking board memberships will help to reduce top-level difficulties, rank-and-file Customs officers can easily frustrate smooth implementation of policy. Training and exposure to smoothly functioning Customs regimes, as in Costa Rica and Mexico, could help in securing full Customs cooperation.

5. Technical Assistance and Training Requirements

7.19 A priority for Belize's free zone program consists of providing technical support services, and limited-duration training, to private free zone developers and managers in Belize. These services should emphasize the ingredients for successful zone planning and development and prepare zone managers for the requirements of their ventures once they reach an operational stage.

D. Proposed Zone Implementation Program

7.20 As has been stated earlier in the report, in order to successfully realize a free zone project in Belize a full feasibility analysis and implementation plan must be prepared. The purpose of this study will be to confirm or modify the project described in this report and to determine with greater accuracy and credibility the various aspects of project development.

7.21 Concurrent with the execution of the feasibility analysis, the Government of Belize should take the steps necessary to institute free zone legislation to provide the regulatory and legal framework essential for zone success. In the course of these activities, the Government should also direct special attention toward the designation of the executing agency for the free zone program, the determination of the scope of its authority, and the formulation of its responsibilities so as to provide the autonomy necessary for its efficient operation.

BELIZE FREE ZONE: FEASIBILITY STUDY AND IMPLEMENTATION PLAN

Outlined on the following pages is a proposed program for the execution of a feasibility analysis and formulation of an implementation plan for the free zone project. During the project teams' visit to Belize in June 1986, discussions were held with members of BEIPU and US AID. In view of BEIPU's role in investment promotion activities, interest was expressed in participating in specific aspects of the feasibility study and implementation plan (Noted by an asterik.) The estimated time allocated to each task is based on the consultants' previous experience in participating in similar projects. Note that many of the tasks can be carried out simultaneously and the time allocated for project completion has been conservatively estimated at nine months.

TASK 1: OPTIMAL ZONE DEVELOPMENT CHARACTERISTICS *

- A. Preliminary market assessment to determine targetted industrial sectors, including comparative cost analysis for each industry
- B. Definition of optimal zone development character

Estimated Inputs: 3 staff/months

TASK 2: INSTITUTIONAL AND LEGAL FRAMEWORK *

- A. Drafting of legislation for free zones in Belize
- B. Design incentives for free zone investment
- C. Determination of optimal regulatory framework for free zones including designation requirements, operational guidelines and executing agency for the program

Estimated Inputs: 3.5 staff/months, including local counsel

TASK 3: DEMAND ANALYSIS *

Conduct a detailed demand analysis in the targetted sectors to determine zone occupancy projections and prepare necessary promotional materials, including:

- A. Projected demand profile -- medium-term (5 years) and long-term (10-20 years) for the free zone facilities
- B. Preparation of a short-term marketing strategy
- C. Preparation of preliminary promotional literature
- D. Initiation of investment promotion activities

Estimated Inputs: 5 staff/months

TASK 4: SITE ANALYSIS AND PRELIMINARY ENGINEERING

Conduct requisite site investigation at Santa Elena, including:

- A. Site surveys
- B. Soil investigations

- C. Determination of requirements for zone services, including water and sewerage, electricity, telecommunications, and transportation

Estimated Inputs: 1.5 staff/months, including engineering services

TASK 5: PRELIMINARY MASTER PLAN AND CAPITAL COST ESTIMATES

Preparation of Master Plan for the zone and capital cost estimates, including the following:

- A. Land preparation -- clearing grading compacting, etc.
- B. External infrastructure requirements (up to zone boundary)
- C. Plot Plan -- internal road layout and subdivision of land into building plots
- D. Preliminary design of SFBs and estimate of number required
- E. Internal infrastructure specifications -- roads and storm drainage, power, gas, water, sewage disposal, telecommunications
- F. Proposed additional common facilities -- administration building, maintenance area, garage and service station, clinic, recreational area, restaurant, etc.
- G. Capital cost estimate

Estimated Inputs: 3.5 staff months, including engineering assistance

(N.B. This task covers only preliminary engineering -- it is expected that the detailed design work will be carried out by the developer)

TASK 6: ZONE OPERATING STRUCTURE

- A. Determination of optimal ownership for the project
- B. Design of zone development program
- C. Determination of managerial framework for the zone, including:
 - 1. Organization chart -- staffing and description of functions
 - 2. Relationship with other private/public institutions
 - 3. Legal requirements
 - 4. Optimal arrangement for the provision of services:
 - telecommunications
 - power
 - water and sewerage
 - transportation
 - business support services
 - maintenance and repairs

Estimated Inputs: 3 staff/months

TASK 7: FINANCIAL SERVICES

- A. Identification and analysis of the need for short - and long-term financing for zone industries
- B. Identification of potential sources of finance
- C. Design of credit facilities for the project

Estimated Inputs: 1 staff/months

TASK 8: FINANCIAL PLANNING AND ANALYSIS

Based upon the demand forecast, capital cost estimates and discussions with interested developers and potential financiers, prepare a financial plan for the project. including:

- A. Costs Projections -- including
 - 1. General overhead and administration
 - 2. Maintenance
 - 3. Marketing and promotion
 - 4. Debt service
 - 5. Taxes
- B. Revenue Projections -- including
 - 1. Land and building rentals
 - 2. Land and building sales
 - 3. Service provision
- C. Income and Cash Flow Statements
- D. Proforma Balance Sheet
- E. Profitability -- Internal Rate of Return
- F. Economic Rate of Return

Estimated Inputs: 1 staff/months

TASK 9: PROJECT PROSPECTUS AND SOLICITATION OF DEVELOPER INTEREST

Using the financial statements prepared in the preceding task:

- A. Preparation of a prospectus for presentation to private developers
- B. Assistance in the promotion of the project to potential developers
- C. Evaluation of offers and participation in negotiations

Estimated Inputs: 3 staff/months

ANNEXES

ANNEX 1: COMPETITIVE LOCATIONS

A. Dominican Republic: Industrial Free Zone Development Program

Program History and Description. The Industrial Free Zone (IFZ) program of the Dominican Republic is widely recognized as one of the most successful and innovative free zone development programs in the Caribbean Basin region. Currently, the country has four IFZs in operation, two more under construction, and nine others designated for near-term development. Of the four operational zones, one is owned and operated by the private sector, another by the government's Industrial Development Corporation (CFI), and the remaining two are run by mixed public/private zone management corporations. As of July 1986, over 3.7 million square feet of under roof factory space has been developed in the country's zones, and, with 124 companies, is fully occupied.

Unlike some other countries with active free zone programs, the Dominican Republic does not have a single comprehensive law regulating free zone development and operations. Rather, Dominican free zones are governed by a complex network of laws, Presidential decrees, resolutions, and the like, each dealing with a specific area such as free zone development, incentives, finance, and labor, among others. Similarly, there is no central Free Zone Corporation dedicated to free zone operations, as is the case in other countries. While the major free zone-enabling legislation was passed in 1968, the primary impetus for IFZ development came not from the public sector, but the private: in 1969, the La Romana IFZ was started by the US multinational, Gulf & Western.

Although some of the zones are located close to major urban centers (eg, Santiago), the GODR's free zone development program has emphasized the establishment of free zones in outer areas in order to decentralize economic activity, and create new geographic growth poles. The newer IFZs, however, are located close to the capital, Santo Domingo.

Overall, the Dominican IFZ program has been a great success: with the exception of the sugar industry (which, of late, was the primary export earner), there is no other sector in the economy that exceeds the overall economic contributions made by the zones in terms of job creation, export earnings, and gross investment. Performance of individual zones, however, has varied greatly: the Santiago zone, with an efficient private sector management has generated an operating surplus each year since startup, while the San Pedro zone, managed by the public sector, requires an annual subsidy even after 10 years of operations.

Performance. The economic record of the Dominican IFZs has been impressive. Since the first zone opened in 1969, employment, export earnings and gross foreign investment in the zones has increased dramatically. As recently as 1983, total free zone employment numbered 19,000; approximately 89 companies had operations in the zones and zone export earnings exceeded US\$150 million per annum. By 1986, in only three years, total direct employment very nearly doubled, reaching 37,000 persons, with an additional 4 to 5 times as many

indirectly employed. Foreign exchange earnings generated by zone exports have exceeded US\$300 million and are projected to increase even more rapidly; the current level of 124 free zone companies is expected to double over the next decade. Consequently, the economic contributions of the IFZ program can be expected to be even more dramatic; already, free zone exports account for fully three-quarters of the country's non-traditional exports.

However, the IFZ program has failed to meet two of the GODR's primary objectives: to increase and strengthen economic linkages between free zone companies and Dominican industry, and to stimulate and facilitate 'technology transfer'. This situation, however, is not so much a condemnation of the free zones per se, but rather the reflection of the erroneous policies of the GODR of excessively protecting local industry from foreign competition, thus fostering small and inefficient local industry, incapable of supplying the inputs needed by free zone firms at internationally-competitive prices.

Problems and Constraints. It is clearly evident that the Industrial Free Zone program of the Dominican Republic has been largely successful. At the same time however, there are a number of very important obstacles constraining further development. For example, the country has, at present, the greatest pent-up demand for free zone space of any country in the Caribbean Basin. Foreign investors often wait 12-24 months for factory space, or pay in advance more than 50 percent of the construction cost of their buildings. The reasons for this situation are both complex and numerous.

A recently-completed study by FZA identified eight principal constraints to free zone development, namely:

- o a lack of a businesslike, profit-oriented approach by some zones to development;
- o difficulties in gaining access to both public and private sector financial resources for zone expansion;
- o uncertainties over government policies and procedures caused by frequent changes and lack of permanent legal and institutional structures;
- o archaic regulatory and bureaucratic procedures and requirements;
- o constraints on the self-provision of infrastructure and services;
- o restrictions on the provision of air freight and telecommunications services by foreign firms;
- o insufficient and undeveloped channels for communication and interaction by free zone users and government bodies; and
- o financial and logistical problems in initiating large-scale factory construction projects.

Perhaps the most important of these factors is that legislation targeted at stimulating the private financing (both foreign and domestic) of zone infrastructure development -- such as that currently available to free zone users and hotel developers alone -- simply does not exist. The result of this is a situation unique to the Dominican Republic: demand for free zone factory space has far out-stripped current supply, with the outlook for accelerated near-term development highly dependent on the immediate enactment of needed policy reforms by the government.

Outlook. The Dominican Republic will, within a few months, embark upon a multi-million dollar development program aimed at strengthening national institutions for effective export and investment promotion. One key element targeted in the ambitious, multi-sector project is the development, expansion and formal promotion of the country's industrial free zones.

It appears likely, therefore, the foreign investor demand for free zone space will increase even more rapidly; some estimates have indicated that an additional 1 to 1.5 million sq.ft. of factory space will be needed within the next five years above and beyond the 3.7 million sq.ft. currently projected to accommodate this incremental demand, a development that does not bode well given the dearth of incentives presently available to the free zone developer.

As such, it is clear that only if the government seriously undertakes a multi-pronged effort at ameliorating the many hurdles constraining the realization of the country's intrinsic free zone potential, the near-term outlook for the IFZ program will remain exceptionally bright; easily positioning the Dominican Republic at the forefront of Caribbean Basin free zone programs.

B. Jamaica: Free Zone Development Program

Program History and Description. Jamaica has, at present, two fully-functioning export processing zones, and a third under active consideration. The first such zone, the Kingston Free Zone, was established by the Port Authority of Jamaica in 1976 adjacent to the Port of Kingston in the country's capital. In 1984, following a study by FZA, the country's second free zone was started in the city of Montego Bay. Together, the two free zones have over 1.2 million sq.ft. of under-roof factory space, and employ in excess of 9,000 workers.

The country's free zones are regulated by the Jamaica Export Free Zones Act of 1982, a single, comprehensive law specifically targeted at the development, operations and management of the export processing zones. In comparison to many other Caribbean Basin countries, the many fiscal, tariff and regulatory incentives embodied in the Jamaican law are among the most generous and comprehensive. Additionally, both of the zones' operations are overseen by two autonomous and independent public corporations whose sole responsibility is the management of the zones.

Although the overwhelming majority of the tenants located in the Kingston Free Zone are apparel/garments manufacturers exporting to the U.S. market, the zone has made, of late, promotional efforts aimed at diversifying economic activity. The Montego Bay Free Zone, in contrast, is explicitly aimed at the offshore information and data processing industry, through the provision of specialized training for workers, and by allowing for the establishment of the Caribbean's first privately-owned teleport satellite earth station to facilitate rapid data and voice communications with the United States.

Performance. The development of the country's export processing zones have been, overall, quite successful in providing for the "cutting edge" in its drive to increase export-oriented production of non-traditional manufactures, and allowing for more rational utilization of its harbours and ports. In 1984, the zones' total export earnings exceeded US\$40 million, and net foreign exchange earnings totalled about US\$4.2 million. Over 9,000 people are directly employed by the free zones, with an additional 25,000 indirectly supported.

On the other hand, the free zones have not been able to achieve overall cost recovery: for example, a total of US\$7 million was invested by the public sector in the Kingston Free Zone in 1976-83, but operating deficits have exceeded US\$700,00 per year. The KFZ has, however, increased the supply of revenue-generating space and increased the rental rate of SFB space (in 1985, this was US\$4.20/sq.ft./year, among the highest in the region). Most significant in this respect is the fact that the new free zone planned in the community of Spanish Town outside Kingston, is to be entirely financed and operated by the private sector, thus minimizing the financial burden on the state. In 1986, the two operational free zones housed some 18 companies on an estimated 1.7 million sq.ft. of fully-occupied SFB space.

Problems and Constraints. The most pressing problem constraining the further expansion of Jamaica's free zone program is the general lack of, and accessibility to public investment capital for zone development. In cases where private sector funding exists, the fundamental bureaucratic inertia and inefficiency characterizing the Jamaican free zone institutional environment greatly hampers project development. In the Montego Bay free zone for example, although established in 1984, construction for an initial 60,000 sq.ft. of factory space started as late as December, 1985. As a result, the country suffers from a chronic lack of factory space.

In addition, the zones' marketing and promotional activities are generally underfunded, intermittent and uncoordinated. The primary responsibility for promotion rests with the parastatal Jamaica National Investment Promotion (JNIP), a largely cumbersome and inefficient organization: indeed, although JNIP had helped establish 341 projects by end-1984, total capital investment amounted to a mere US\$11.7 million, two-thirds of which was locally generated. The cost of this promotion was estimated to be several millions of dollars.

A last category relates to the continuing political uncertainty in Jamaica. Although strongly supportive of the private sector, Jamaica is perceived by the foreign investor as a "high risk" location due to its changing economic regulations, inconsistent applications and significant labor unrest. As a result, the country has yet to experience larger, more substantial foreign investments needed to pull the economy out of its present malaise.

Outlook. The previous discussion notwithstanding, the near-term outlook for the Jamaican zones appear to be quite favorable. Despite the poor conditions of the Kingston Free Zone, for example, investors in some industry sectors are willing to wait several months for factory space.

In the next few months, an additional 200,000 sq.ft. of factory space will be available for occupancy in the two operational free zones. Moreover, construction of the Spanish Fort free zone is to start immediately. As such, it appears likely that near-term demands for space will be met.

The country will continue to benefit from its close relationship with the United States, a situation that bodes well for the performance of its free zones: it already aggressively negotiated higher access levels for garment imports to the US under the scheme introduced in February, 1986. Resultant increases in projected garment export earnings are to total US\$81.5 million by 1987, compared to the US\$35 million achieved in 1985. In sum, with its existing inventory of optimal location, low-cost labor, and good external relations with the US, Jamaica can be expected to be a major competitor for free zone investments.

C. Mexican Industrial Estate/Free Zone Program

Program History and Description. Mexico is an outstanding example of a country that has successfully blended private and public sector resources into an effective and rapidly growing national program of industrial park/free zone (IE/FZ) development. Of over 100 formally registered industrial parks, 34 are owned and operated within the public sector (state governments or FONDEPORT, the port operating agency) and the balance are either 100 percent private or joint-ventures of mixed public and private capital. The parks located along the Mexican-U.S. border and in port areas are operated as free zones. Free zone privileges (duty-free in and out movement of goods and other special incentives) are available, nonetheless, to qualified export industries locating within projects in the interior.

Government resources for IE/FZ development are channeled through a specialized institution, FEDEIN, headquartered in Mexico City. FEDEIN's program, it should be noted, is closely coordinated with the activities of several other government agencies -- offering inter alia industrial credit, technical assistance, export promotion services, etc. -- under an "umbrella" operation referred to as PAI (Integrated Program of Support to Small and Medium Industry). In the 1970s, FEDEIN planned, financed and built 19 industrial parks throughout the country. Since one of its objectives is to contribute to the decentralization of industry away from the three seriously congested main urban centers -- Mexico City, Monterrey and Guadalajara -- most of the projects were located near secondary cities and towns, including three in the border zone (Tijuana, Mexicali and Matamoros) operated as free zones.

Although results were mixed depending on location, on the whole, project performance in aggregate was acceptable in terms of capital investment, job creation, gross product value and export earnings. Within the private sector, however, overall performance was far superior. The contrast in sectoral performance, coupled with a decline in government funds availability, led to a revision of policy in 1982. FEDEIN's projects were taken over by state governments and the institution was reconstituted as a finance/technical assistance resource offering medium to long-term credits and project preparation/evaluation and consulting services to IE/FZ sponsors in both the public and private sectors.

Performance. The overall success of the IE/FZ program in Mexico is beyond dispute. Under FEDEIN's aegis alone, project construction started in 1972 and 12 estates were in operation by 1977 employing about 15,000 on 1017 acres of developed land. Two years later, in 1979, there were 16 operating projects employing 37,000 on 2,700 developed acres. (The figures imply, of course, rapid growth in the first 16 estates during the 2-year interval, 1977-79.) FEDEIN's program peaked in 1981/82 with 19 projects employing over 60,000 workers. FONDEPORT, meanwhile, had established 15 projects in port locations, many of which were simply bonded warehouse operations.

Parallel with the public sector program, IE/FZ's in the private sector were expanding at an even more dramatic rate. Although hard data are difficult to obtain in the diffused private business community of Mexico, according to the best estimates of knowledgeable observers, there are about 70 privately owned

(in whole or majority capital) IE/FZs employing at least 230,000 workers (1986 figures). In the border zone alone, there are an estimated 250,000 "maquila" workers in over 700 "maquiladora" industries (private and public sector projects, combined); up from 120,000 in 1981. Export earnings of free zone industries have risen from US\$1 billion in 1982/83 to about US\$1.5 billion in 1985, second only to petroleum exports as a generator of foreign exchange.

Problems and Constraints. There are no serious problems hampering the growth of IE/EPZ operations in Mexico other than limited financial resources (in both the public and private sector) and the looming threat of increased protectionism in the U.S. and other advanced countries.

Outlook. FEDEIN is currently providing technical assistance and/or construction finance to over 80 of the established IE/EPZs and to new projects as they apply. Available funds (partly from World Bank loans) in the public sector and additional funding from the private sector should keep the program growing at a modest rate over the near-term. At such time as Mexico's credit rating improves, and assuming no major wave of protectionist legislation in Mexico's market countries, the program could resume the former "explosive" rate of growth.

D. El Salvador -- Free Zone Program Status

Project History and Description. As of mid-1986, El Salvador had one operating free zone -- the San Bartolo Industrial Free Zone (SBIFZ) located 6 miles east of the capital, San Salvador, on the Panamanian Highway. The project has a total area of 211 acres, of which 30 percent or 63 acres have been developed into fully-serviced industrial plots. Thirteen standard factory buildings were erected between 1974-78 with a total rentable area of 425,000 sq.ft. The Ministry of Labor established a vocational training center within the boundaries of the zone to assist in providing skilled workers to on-site industries while serving the needs of the economy across-the-board. Other facilities installed during the initial construction period (1974-78) include: four cafeterias, off-site housing for the free zone work force and an administration building. The project is owned and administered by the Ministry of Foreign Trade (MICE).

Performance. At its peak in 1979, the SBIFZ housed 14 firms -- the majority foreign, producing apparel/textiles (7), metal products (5), ceramics (1) and shoes (1) -- employing over 4,000. Because of the deteriorating political situation and social unrest, by 1982 only four companies remained, employing about 800. In 1983, however, occupancy began to rise and there are now nine operating companies employing almost 2,000 workers.

Problems and Constraints. Typical of most public sector projects, the free zone has never generated a profit, even during the "boom" years (1978-80). The problem is primarily one of pricing -- SBIFZ facilities are leased at rates running about 35 percent of the economic level or "market" rate needed to cover all costs and generate an operating surplus in real terms. Additionally, the central office and on-site staff totals 65 which, by any measure, is far beyond the true need. Many management responsibilities such as promotion and maintenance, are well executed.

With the slow improvement in the investment climate (in parallel with an apparent reduction in the intensity of the political/social conflict), increased interest in zone facilities has surfaced; firm applications for industrial space are in the pipeline.

Unfortunately, the army has been occupying 125,000 sq.ft. in five of the 13 SFBs for some years and, until alternative facilities are made available to the army, new industrial occupants will have to wait.

Outlook. El Salvador has recently (March 1986) promulgated a new Export Promotion Law which inter alia specifically focuses on improving the free zone program. The law encourages private sector participation in free zone finance and management and also aims at streamlining import-export procedures, international promotion and institutional performance and efficiency.

Besides expanding the SBIFZ project over the near term, two or three additional zones are in the planning stages. Institutions such as the World Bank, the IDB and USAID are either actively supporting the Government with long term credits and grants or planning to do so in the near future. If the

The Parque Industrial Cartago received free zone status in 1985, and now offers tenants all incentives and services available to free zone operations, including on-site Customs inspections. Although the industrial estate continues to accommodate non-export companies, 20 firms investing a total of US\$20 million already have located at the Cartago site.

Problems and Constraints. One of the primary obstacles to free zone activity in Costa Rica until recently was a legal commitment in the original zone statute that no further designations would be made until the Santa Rosa and Moin sites were fully developed. Most potential foreign investors who visited Costa Rica has expressed interest in operating in the Central Valley area, near the major population centers and the international airport.

This problem was compounded by a reluctance on the part of Banco Anglo Costarricense to release funds earmarked for infrastructure development at the Moin and Santa Rosa zones. The Government of Taiwan has established a US\$3 million fund to support construction of roads, sewers, site preparation and factory shells, but the bank has yet to permit the intended expenditures of the monies, citing Costa Rica's past foreign-debt problems.

Yet another barrier to full implementation of Costa Rica's free zone policy has been the country's generally poor economic performance in recent years. Costa Rica had prospered until a disastrous devaluation in 1979 that wiped out much of the country's privately held wealth and ended an era of ambitious economic development. With a foreign-debt overhang of more than US\$3.5 billion, Costa Rica is now one of the most indebted countries in the world per capita. The country's crippled economy has meant a lack of both public investment to stimulate free zone development and private capital available for export manufacturing or for joint-ventures with foreign investors.

Outlook. Costa Rica's economic turmoil may at least indirectly be leading to needed reforms and solutions that will in the long run spur new free zone investment. For example, before the 1979 devaluation Costa Rican labor was considered somewhat overpriced, compared to wage rates offered by its major competitors, such as the Dominican Republic. Prevailing wages remain somewhat high, but the general educational level in Costa Rica is also higher than in surrounding countries.

This may bode well for development of free zone firms oriented toward more advanced kinds of training, including service industries such as data entry operations. Costa Rica already has one of the most sophisticated telecommunications systems in the region and may be well positioned to use satellites to link information-based companies operating in free zones with users even in North America.

Another result of the economic problems of recent years has been the increased willingness of the central government to "privatize" public services and facilities. The transfer of a large portion of the Santa Rosa free zone to a private operator is clear evidence of this change in policy. The CZF now formally encourages private developers to explore the prospects of establishing free zone, and is now evaluating the merits of at least seven possible sites in the vicinity of the airport north of San Jose.

socio-political environment continues to improve, El Salvador will be an effective competitor in the international marketplace for free zone investment.

E. Costa Rica--Free Zone Program Status

Project Data. Costa Rica currently has three general purpose export processing zones and a new subzone to accommodate an agro-business project. When the government first authorized zones in the late 1970s, it designated one site at Santa Rosa, near the port of Puntarenas, and one at Moin, adjacent to the Caribbean port of Limon. Within the past year, Costa Rica authorized free zone status for an industrial estate at Cartago, about 10 miles south of the capital city of San Jose in the Central Valley.

The new designation at Cartago signaled a change in the country's free zone and export manufacturing policies. The free zones were part of a set of laws that encourage manufacturing under drawback provision and under an "export contract," which authorizes incentives regardless of a firm's location. Costa Rica now appears ready to coordinate all three of these strategies, while increasing the number of free zone designations. As a result, government officials anticipate that free zone investment will rise significantly from its current level of less than US\$30 million.

Performance. Of the two original zones, the Moin site has been more fully developed, with most of the necessary infrastructure ready to serve 112 acres of its potential area of 1000 acres. Three standard factory buildings, with a total of 9,900 sq.ft. of space have been built. Since it was activated in 1981, only three tenants have taken space in the zone, two garment makers and a banana chips manufacturer. Only the food processor, occupying 3,300 sq.ft., remains today.

The Puntarenas zone remains only partially developed and has no tenants as yet. But in June of this year, the Corporacion de la Zonas Francas (CZF), department in the Ministry of Exports that has responsibility for the country's zone policy, signed an agreement with a private-sector firm that will both use and operate the zone. CZF has turned over 75 acres of the total zone area of 115 acres to Consorcio Metalurgico de Caribe, S.A., (COMECA), which will help complete infrastructural work at the zone and will become responsible for the zone's day-to-day administration and promotion. COMECA will also produce metalurgical and metalmechanical products in the zone, with groundbreaking scheduled later this summer for the first phase of its manufacturing operations. COMECA expects to begin actual production in a US\$4 million, 23,100 sq.ft. facility within 18 months.

In the southern area of Costa Rica, the United Fruit Company has been given free zone designation for a project at Coto Sur. The surrounding area was devastated economically by the closure of large-scale private banana plantations and their ancillary packaging and shipment operations. United Fruit has opened a commercial cloning operation for West African Palm seeds, which is presently producing approximately 400,000 seeds per year. United Fruit envisages that this operation may expand significantly by next year to a level of 4-5 million seeds annually. The privately-owned site contains sufficient room to house additional firms, which are expected to share an agro-industrial orientation. As part of its agreement with the Corporacion de la Zonas Francas to receive free zone designation, United Fruit sold for one colone a 15-acre site that also will be developed for zone users in the area.

CZF is also investigating the feasibility of converting CENADA, an agricultural marketing and warehousing facility near San Jose, into a free trade zone. This 107.5 acre site, although nearly unoccupied, is ideally located along two major transportation axes and could support several light manufacturing firms. The property has about 66,000 sq.ft. of space under roof and a 4,290 sq.ft. facility for zone administration and Customs.

Costa Rica has been in the process of restructuring its free zone policy over the past two years and appears to be on track to open more area for such development and to attract new kinds of business to operate in its zones.

ANNEX 2: PUBLIC SECTOR SOURCES OF FINANCE

Caribbean Development Bank

Within the Caribbean region, the Caribbean Development Bank (CDB) has been one of the main sources of finance for free zone and industrial estate projects. In making its loans to member countries, the CDB draws from funds provided by various external sources, including the World Bank and InterAmerican Development Bank. /1 Throughout the OECS countries and Belize, industrial park projects have been financed using CDB's Special

Operations funds with the following terms and conditions:

1. Debt/Equity ratio: The CDB usually requires a ten percent equity contribution from the Government or its executing agency, which, under certain circumstances, can be waived;
2. Repayment: The term of the loan is generally 20 years, including a five year grace period on principal and interest;
3. Interest Rate: Lending rates from Special Operations are generally 4 percent for free zone projects, inclusive of a service fee of one percent.

Due to the attractive terms and conditions, most member countries of the CDB eligible for Special Operations funds have relied upon this concessional finance for development of industrial facilities. In Belize, for example, the Ladyville Industrial Estate has been financed by the CDB. The stringent conditions precedent for approval and disbursement, however, have been the trade-off involved in utilizing this financing mechanism. The major issue related to the approval of the industrial estate loans appears to be the assessment of demand for industrial space. The CDB often requires letters of agreement and/or "firm" letters of intent from potential investors as a basis for formulating demand projections. Investors, of course, are reluctant to provide commitments to the designated agency in the absence of any credible time-table for the development of industrial facilities. In most instances, the lengthy negotiations result in agreement with CDB to build a limited amount of factory space, say 10,000 sq. ft. ahead of "firm" demand. /1

A further delay occurs in the disbursement of funds. The period from the time the executing agency decides to commence construction of a new building to the time construction is completed is commonly between 15 and 30 months. This extraordinarily long lag time is the result of a number factors, including the unduly complex contracting, tendering and approval procedures plus the construction requirements.

/1 Since 1985, USAID no longer provides direct funds for financing industrial estate and free zone projects in the Caribbean.

/2 See "Evaluation of the USAID Employment/Investment Promotion II Project", Arthur D. Little, Inc, 1984. This assessment is also based on a review of CDB industrial estate loan documents in OECS countries.

15

The CDB also imposes certain restrictions on the executing agency. Until the loan is repaid, the borrower is not permitted to sell the facilities to an investor. In addition, custom designed facilities or infrastructure development aside from basic roads, power, water and sewerage are not eligible items for finance. These conditions limit the range of products that can be offered to potential investors, which has, at times, resulted in the loss of customers. Certain normal operating costs, such as investment promotion activities, are generally not considered eligible for finance.

In summary, the CDB's Special Operations funds for development of industrial estates and free zones offers potential borrowers low interest, long-term funds with reduced risk. In theory, the five-year moratorium on interest and principal should enable the executing agency to establish a positive cash flow and a cash surplus in the early years of the project. However, these theoretical benefits are substantially negated by the conditions precedent for disbursement, lengthy delays in construction and restrictions on the range of products which can be offered to potential investors, which reduce the potential economic benefits of a project.

The World Bank

Within the Caribbean/Central America region, the World Bank has been involved in the finance and development of five free zone projects: Kingston Free Zone, Jamaica; Cartagena, Colombia; Colon Free Zone (extension), Panama; Mexico (various locations); and a country-wide Barbados (various locations). The term of the loans has varied ranging from 14 years to 20 years, according to individual needs. The interest rate varies with current market rates, and is normally lower than LIBOR. For example, the current World Bank interest rate is 8.25 percent. Unlike the CDB, however, the World Bank has adopted a more aggressive marketing stance for free zone projects and usually encourages the executing agency to maintain an inventory of factory space in order to capture potential investors in a timely manner.

For each project, the World Bank has adopted an integrated approach to free zone development, including the finance, design and supervision of promotion programs, infrastructure and superstructure development, and support services to industries. As with the CDB, the project cycle is lengthy, averaging from 12 - 18 months from project identification to loan approval. Actual construction of free zone facilities usually requires an additional 14 months, depending upon the borrower's ability to meet the conditions precedent for disbursement and ability to satisfy the engineering and technical requirements established by the World Bank.

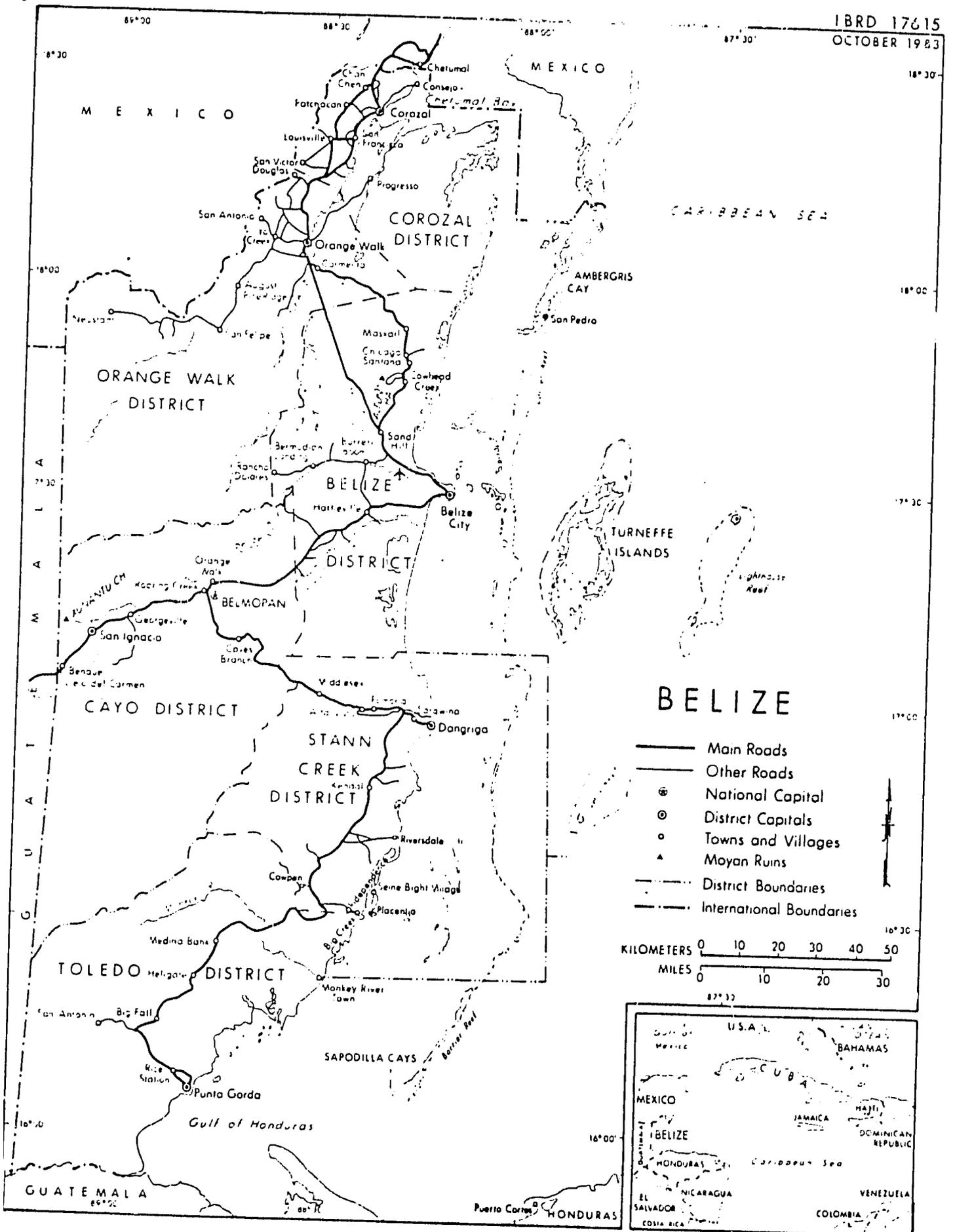
Informal discussions held with World Bank staff members indicate that there is no current lending program for Belize. Discussions to formulate a lending strategy are scheduled to be held before the next annual meeting in September 1986. In the event the GOB views this project as a high priority public sector project and wishes to pursue financing with the World Bank, an opportunity to begin discussions presently exists.

66

Other Sources

Through bilateral agreements, agencies such as the Export-Import Bank of Taiwan have been involved in free zone development. In Costa Rica, for example, the government of Taiwan has given a US\$3,000,000 concessional loan for the construction of free zones and industrial parks. This facility, which is held in trust by private commercial banks has been on-lent in local currency to both the public and private sector. Similarly, the Canadian government has, upon occasion, provided finance for infrastructure development in the event free zone development was one component of a larger project.

In most instances, these potential sources of funds should be viewed as secondary sources. Grants or loans are generally made on a "on-off" basis and are insufficient to meet the medium and long-term demands of a free zone project.



152000E

153000E

Four Mile Lagoon

Four Mile Lagoon

Four Mile Lagoon

138 70.1
(3364007)

GENERAL MAP OF THE AREA

FOUR MILE LAGOON