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Recommendations on Egypt's Free Zones

November 2005

This publication was produced by Nathan Associates Inc. for review by the United States Agency for International Development.

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1. Introduction

This study is part of a project for improving Egypt's trade and policy framework and regulatory climate.¹ The new leadership of the General Organization for Foreign Investment and Free Zones (GAFI) is seeking to vitalize Egypt's free zones. It has two goals:

1. Increase the utilization of its properties.
2. Encourage greater foreign and domestic investment in production in Egypt, especially in production for export.

Westgate Consultants provided a diagnostic of various operational aspects of existing zones (e.g., reviewing operating procedures with a view to streamlining them or introducing organizational reforms to make zone administration more responsive to investors' needs). The purpose of this study is to provide GAFI guidance and assistance on (1) international best practice in relation to day to day operations of free zones, and (2) the structure and competitive positioning of free zones

OVERVIEW OF FREE ZONE DEVELOPMENT

The free zone and related concepts have long been used to promote trade in and through particular locations. Until the middle of the 20th century, free zone activity was limited to trading. Manufacturing was prohibited. This changed in the 1960s with the advent of the industrial free zone, or export processing zone (EPZ). In the EPZ, equipment and materials were imported free of customs duties and restrictions on processing and export. Successful free zones were established in locations with a favorable investment climate, low operating costs, and good international transport services. Free zone production was concentrated in industry sectors that involved assembly processes using imported raw materials. Garment manufacturing and electronic assembly were dominant activities in most free zones.

The concept was modified in the late 1970s to facilitate the growth of private enterprise within a communist region, with the establishment of special economic zones (SEZs) in China. In the 1980s the concept was used to promote international services. In Dublin, a financial services center or zone was established to promote international financial service activity—and with considerable success. The range of manufacturing activities in free zones has expanded. Local raw materials are being processed in some recently established zones in Africa.

A free zone means not only freedom from customs duties but also an area that is secure and free of bureaucratic interference and maladministration, infrastructure problems and

¹ This report was prepared by Tom Kelleher, who visited Egypt October 2-18, 2005.

difficulties, financial restrictions, including currency controls, and restrictive regulations (e.g., employment or ownership restrictions). In some countries, the advantages of security, sound infrastructure, and lack of bureaucracy are far more important than customs benefits. For example, in Albania a developer planning an industrial park wanted free zone status for the park to give investors a secure environment and protection from bureaucratic interference; the right to import materials free of duties and taxes was a minor consideration. The SEZ concept has been used in some Eastern European states to promote the development of underdeveloped regions.

The free zone is sometimes viewed as an “export only” base from which domestic market sales are prohibited or seriously restricted. This was so with many EPZs established in the 1960s and 1970s, but the number of exceptions is growing. Most goods passing through U.S. foreign trade zones (of which there are more than 300) are destined for the U.S. market. A significant percentage of the output of Middle Eastern free zones is sold on the domestic market (e.g., Syria, Jordan, and Egypt). Nevertheless all of the most successful zones are strongly oriented toward exports.

ROLE OF FREE ZONES

Free zones should be regarded as a temporary or second-best option to wider improvements. Within the zone, investors enjoy duty-free facilities and other benefits, such as fiscal, legal, and administrative advantages, and sound infrastructure within a limited area. The best option is a regime that provides similar benefits and facilities countrywide, not just in limited geographic or administrative areas.

If well planned in a national framework, a free zone should begin moving a country toward a streamlined, duty-free, bureaucracy-free regime. The free zone should demonstrate the benefits of efficient administration and sound infrastructure. It should also enable a country to experiment with administrative procedures or system-wide innovations before extending innovations countrywide. A free zone program is successful when it is no longer necessary. At Shannon, for example, the free zone continues to exist as a legal entity, but many free zone trappings have disappeared. There is no customs control at the zone boundary. Many of the companies operating in the zone do so “out of customs control”—they pay duty on materials and equipment at the point of import.

A World Bank paper—*Managing Entry into International Markets; Lessons from the East Asian Experience*—noted that free zones can be very effective in the early stages of an export drive in attracting foreign investors and demonstrating a country’s export potential. Over time, however, the importance of zone exports should decline as export investors are attracted into the wider economy and as a strong export base develops in the wider economy.

Export figures for the Shannon free zone illustrate this point. As the zone developed though the 1960s, Shannon’s share of Irish industrial exports increased from 0 percent in 1960 to 20 percent of national exports in 1964 and 32 percent in 1966. From the mid-1960s large numbers of foreign investors were attracted into the wider economy. Shannon’s exports continued to increase in absolute terms after 1966 but declined steadily in percentage terms—falling to 12 percent by 1973 then to 4 percent by 1991 (Table 1-1). Statistics on many of the successful zones of East Asia reveal a similar pattern.

Table 1-1
Shannon Free Zone Exports

Year	Free Zone Exports (£m)	National Exports (£m)	Share of Zone Exports in National Exports (%)
1964	14	69	20
1965	22	81	28
1966	32	100	32
1969	38	162	23
1973	47	400	12
1991	385	10,526	4

SOURCE: Shannon Development.

If a free zone is to have an impact on the wider economy and not become an enclave, close links must be encouraged between the zone and the surrounding area. This requires

- Identifying free zone business opportunities for local businesses,
- Facilitating technical links between the free zone companies and local suppliers,
- Encouraging skilled and experienced zone employees to establish businesses, and
- Promoting links between zone companies and local trading and educational institutes.

At Shannon, these links were encouraged and promoted in many ways, especially at the Board level in various institutions. The Free Zone Authority Management was involved at the Board level in training and education institutes, and senior personnel from those institutes were involved at the Board level in the Authority. Free zone type investors were involved in the Boards of both the Authority and the institutes. The Authority instituted a “linkage program.” The Industrial Development Authority later embarked on a similar program countrywide.

A plan or strategy for bringing about the evolution of the zone from a center of low technology activity to medium to high technology is also needed. This evolution will rarely occur automatically or easily. In fact, a free zone can remain in “a state of low technology equilibrium” for decades. For example, the Dominican Republic’s free zone program began in 1969 and low technology assembly continues to be its principal activity. In contrast, many of the free zones in the Far East have moved from assembly to medium and high-tech manufacturing in 20 years.

A free zone can assist promotion of foreign direct investment, especially during the initial stages of a promotion drive. Investors worldwide are familiar with the free zone concept. Inviting a foreign investor to establish a business in a free zone carries more weight than a simple message to come to a particular industrial park or city, especially in a country or region without a record of attracting foreign investment. A working party established by the U.K. Treasury in 1983 on free ports in the U.K. found that “a free zone of the classic type with a ringed fence under Customs control could have special appeal and marketability.”

The ideal conditions for using the export processing zone as an instrument of economic development policy include the following:

- A government embarking on an export-oriented economic development program to attract foreign direct investment and generate employment opportunities, earn foreign currency, and introduce new skills, technologies, and business opportunities.

- A domestic economy handicapped by infrastructure deficiencies and bureaucracy throughout most of the economy.
- Proximity to good international transport connections.
- A good urban environment.
- An economic policy that favors foreign direct investment and export growth.
- High level and visible government commitment to the policy.

Businesses that benefit the most from the main features of an efficient free zone (i.e., good international transport services, efficient ports and airports, and customs procedures that allow for speedy movement of goods through the zone and to and from foreign destinations) are those that operate on a just-in-time (JIT) basis and require daily shipments of raw materials for processing and dispatch. Industry sectors in this category include garment production, electronic assembly, production and assembly of medical equipment, pharmaceuticals, light engineering, and distribution. These sectors dominate many of the world's successful zones.

Processors of basic raw materials (agricultural or mineral) do not need free zone facilities because they don't receive raw materials daily or operate on a JIT basis. Proximity to a bulk port or raw material source is a critical factor in many cases.

2. Egyptian Economic Context

ECONOMY

Egypt's rapidly growing population—the largest in Arab countries—limited arable land, and dependence on the Nile continue to overtax resources and stress society. The government has struggled to prepare the economy for the new millennium through economic reform and massive investment in communications and physical infrastructure.

Lack of substantial progress on economic reform since the mid-1990s has limited foreign direct investment in Egypt and kept annual GDP growth in the range of 2 percent to 3 percent in 2001–2003. The situation has since improved. The main challenges now facing the country include

- Creating jobs for the large numbers of unemployed and those leaving school and seeking jobs (600,000 leave school annually); and
- Increasing exports so the country can pay its way.

Much is expected of the private sector but the sector has to contend with infrastructure problems and bureaucracy. In this context, foreign direct investment is expected to be critical. The emphasis will be very much on labor-intensive investments and exports.

INVESTMENT CLIMATE

According to an assessment by UNCTAD, reforms by the Government of Egypt could pave the way toward more foreign direct investment. Major reforms in FDI entry rules, customs procedures, foreign exchange requirements, and labor regulation have already been made, many on the basis of UNCTAD recommendations presented in a 1998 investment policy review (IPR). A follow-up assessment concludes that if momentum for change is maintained, 80 percent of UNCTAD's original recommendations will be implemented by year's end. The new Ministry of Investment is "injecting additional dynamism" into investment-related policies and institutions, according to UNCTAD, and a progressive new management team has been appointed to the General Authority for Investment and Free Zones (GAFI). A checklist of initiatives shows a "strong" implementation record. UNCTAD has found that the government is listening more to investor concerns and acting more quickly on them: "A vision may be taking hold among legislators and policy makers of a fundamental change in the relationship between the public and private sectors—one that its architects are confident will enable private investment to flourish and to benefit Egypt."

Despite the positive conclusions of the UNCTAD review, investors still face many problems with bureaucracy. Last year, the ATR Project conducted a survey to determine the time taken to clear goods through customs and ports and found that

- It takes, on average, 22.3 days to clear goods from ship arrival to final release;

- 44.3 percent of cases complete the process in 15 days or less; and
- Another 19 percent are released in 16–21 days.

On average, a shipment completes

- Port procedures in 6.6 days;
- Customs procedures in 12.5 days; and
- GOEIC procedures in 9.1 days.

These numbers hide a lot of variation. There are very good cases and very bad ones.

EGYPT AS AN INVESTMENT LOCATION

From a geographic perspective, Egypt is an excellent location for producing a wide range of labor-intensive goods and services for export. Its well known advantages include

- Central location,
- Market access (trade agreements with Arab countries, COMESA, Europe),
- Ports on the Mediterranean and Red Sea,
- Political and economic stability,
- Good infrastructure,
- Reasonably priced utilities,
- Low labor costs,
- Business reforms (e.g., customs, banking),
- Legal reforms,
- University graduates,
- Business support services, and
- Government/legal guarantees

Despite these advantages Egypt has not attracted significant volumes of investment—foreign or domestic—in export-oriented, labor-intensive industry sectors. Its performance compares poorly with that of its neighbors (Table 2-1). In addition, in recent years the average annual FDI inflow into Egypt has decreased whereas in all the other countries it has increased.

Table 2-1
Average Annual FDI Inflows

Country	1992–1997 (\$m)	1998–2003 (\$m)	Per Capita (\$)
Tunisia	457	618	65
Morocco	551	1179	39
Jordan	67	292	59
Romania	402	1,329	60
Bulgaria	149	994	124
Czech Republic	1,304	5,283	528
Turkey	750	1,265	19
Egypt	820	795	12

SOURCE: World Investment Report 2004.

3. Egypt's Free Zones Program

OBJECTIVES

The Egyptian free zones program began in the mid-1970s with the establishment of zones in Port Said, Suez, Alexandria, and El Nasr City. The Ismalia zone was established in 1979 and Damietta in 1992. Media City was established in February 2000.

The objectives of Egypt's free zone program as set out in "Development of Free Zones in the ESCWA Region," published in 1995 in New York by the United Nations on behalf of the Economic and Social Commission for Western Asia, are to

1. Attract local and foreign investment.
2. Create economic development in different parts of the country.
3. Improve the balance of payments by adding hard currency to the government treasury.
4. Create employment opportunities and improve labor skills.
5. Attract population to remote provinces.
6. Establish new industries that would benefit from local resources in each province.
7. Boost port traffic.
8. Provide essential primary goods and material for local consumption.

Building population in remote provinces is not a realistic objective for a free zone program. A successful zone needs a good urban environment and easy access to good low-cost international transportation. Many free zones have failed when established in remote areas far from modern transport and business support services (see Appendix B.)

In addition, industries processing local resources usually need to be close to the resources or to a bulk products shipping terminal. The main feature of a free zone—streamlined customs procedures and the right to import equipment and raw materials duty free—are of little relevance to industries processing local resources. Of course, such investors might be attracted to a free zone by a tax holiday.

Providing essential primary goods and material for local consumption is not a function or objective of an export processing zone. In the free zones of Jordan, Syria, and Egypt a number of traders sell mainly (70 percent or more) into the domestic market. They make no significant contribution to economic development, create few jobs, do not earn foreign currency, and contribute little or not at all to technology development. Yet they benefit from all the privileges and incentives the free zone has to offer. In fact, it can be argued that their presence in the zones is counterproductive. Because they are storing a range of finished products for sale in the domestic market customs controls are probably more stringent than might be the case otherwise.

ACHIEVEMENTS

Egypt's free zone program has had limited success in attracting foreign investment. From 2000–2004, 75 percent of total investment came from Egyptian sources (see Table A4, Appendix A). The ESCWA study showed that the foreign share of equity investment in free zone projects up to June 30, 1994 was 37 percent. A UNIDO Free Zone study published in 1995—Export Processing Zones: Principles and Practice—showed that 44 percent of free zone projects were of domestic origin and 32 percent were of foreign origin, and that 24 percent were joint ventures by foreign and domestic investors. Free zones where garment investment dominates have a high percentage of domestic investors. Where electronics is the dominant industry (e.g., East Asian countries and Costa Rica) upwards of 60 percent is foreign investment.

Egypt's free zone program is concentrated in the Nile Delta region and Cairo. It has not created employment in different parts of the country or attracted population to remote regions. By August 31, 2005, the free zone program had resulted in 103,074 job opportunities in operating projects. Table 3-1 compares the performance of Egypt's program with that of successful free zone programs in other countries.

Table 3-1
Free Zone Employment

Country	Employment		
	In the Zone (000's)	Per 000 Population	Per Project
Mauritius	84	76	164
Malaysia	322	15	80
Taiwan	260	26	492
Tunisia	240	26	96
Dominican Rep	183	23	326
Morocco	71	2.6	1127
Turkey	31	0.5	9
Jordan	100	16	127
Philippines	820	11	867
Egypt	103	1.5	162

SOURCE: ILO Free Zones Employment Survey.

Most countries with successful free zones have 10–25 jobs in free zones per 1,000 of population. Total manufacturing jobs per 1,000 of population ranges from 60 to 100 in most countries. Free zones therefore account for about 20–30 percent of manufacturing employment.

In Egypt, about 4 million people work in the manufacturing sector. Free zone employment accounts for only 2 to 3 percent of manufacturing employment. If Egypt were to match the employment performance of the more successful zones and achieve a ratio of 10 free zone employees per 1,000 of population, nearly 700,000 people would be working in free zones.

A number of the new 103,074 jobs would have been created in the absence of a free zone program, especially in the petroleum and trading sectors, but some jobs in the garment sector

and on particular projects, such as Leoni, would not. The garment sector accounts for more than half of Egypt's free zone jobs (55,000 jobs). Garment investors are emphatic in their desire to be inside the free zone. Nevertheless, some of the jobs in the garment sector—say 50 percent or 28,000 jobs—would materialize in the absence of free zones. Leoni and some other engineering or assembly-type investors, who employ about 8,000 people, would not be in Egypt but for the free zone program. Overall, about 36,000 free zone jobs would not have materialized in the absence of the zones.

The free zones have made a limited contribution to foreign exchange earnings. In the last five years, imports exceeded exports (see Table A6). Unlike most free zones, which export upwards of 90 percent of their production, exports account for less than 60 percent of sales from Egypt's free zones (see Table A6). With a large volume of domestic market sales a reasonably strict customs regime is necessary to avoid smuggling.

Despite the relatively poor performance overall, there are some successes. Employment has increased substantially in recent years. In 2003, there were 85,000 jobs in approved projects. By 2005 there were 142,000 jobs. The garment sector has grown substantially. The Leoni company in Nasr City, which has achieved spectacular growth over the last eight years, now employs 3,000 people.

CONCLUSIONS

So far, Egypt's free zone program has made a limited contribution to general economic development. Zone performance has been poor largely for two reasons. First, the quality of support services provided to investors by the zone administration and customs administration is inadequate; and second, the zones have not been promoted.

4. Future of Egypt's Free Zones

Do free zones have a future in Egypt given their poor performance so far? Yes, especially given the new and strong focus in government policy on foreign investment and export growth. Zones provide key marketing points for the Ministry of Investment and can still offer specialized services to export-oriented industries that cannot be made generally available in the rest of Egypt. Moreover, changes in economic policy now being implemented, while promoting growth and investment throughout the country, create classic conditions for establishing and expanding free zones as part of an overall economic strategy:

- The government is embarking on an economic development program based on export growth and foreign direct investment.
- The country has a good urban environment, especially around Cairo, and good international transport facilities.
- New economic policies favor export growth and foreign direct investment
- Serious infrastructure deficiencies exist outside of free zones.
- High-level government support exists for such projects.

Of course favorable conditions alone are insufficient. The development, growth, and management of free zones must follow “best international practice.”

COMPETITIVE POSITION

A GAFI promotional slide presentation, quoting Japan's external trade organization, shows that Egyptian labor, utility, and transport costs are significantly lower than those of its Mediterranean neighbors or East European competitors. Egypt enjoys a central location with ports on the Mediterranean and Red Sea; duty-free access to African, Arab, and European markets; and recently gained duty-free access under certain conditions to the U.S. market. In addition, a large number of university graduates enter Egypt's labor market each year. Ireland's abundance of university graduates and technically qualified graduates proved critical to its success in attracting foreign direct investment. The GAFI could possibly benefit from studying the IDA's highly successful advertising campaign—“The Young Europeans.”

Corruption in Egypt is comparable with that of its neighbors. Egypt is ranked 77 out of 134 countries. Its investment potential also matches that of its neighbors (see Tables 4-1 and 4-2).

Table 4-1
Corruption Perception Index 2004

Rank	Country	Index
54	Bulgaria	4.1
87	Romania	2.9
39	Tunisia	5.0
77	Morocco	3.2
37	Jordan	5.3
77	Turkey	3.2
77	Egypt	3.2

SOURCE: Transparency International.

Table 4-2
Inward FDI Potential

Country	1988–1990	2000–2002
Bulgaria	42	64
Romania	85	83
Tunisia	66	71
Morocco	73	93
Jordan	65	45
Turkey	64	72
Egypt	69	70

SOURCE: World Investment Report 2004.

POSITIONING AND DEVELOPMENT

Egypt has the basic conditions for successful free zone development—central location, international transport, urban environment, market access, and competitive cost structure. But that is not enough. In computer terms, this is “excellent hardware.” To function properly and to attract good export-oriented investors in labor-intensive and technology-based sectors, the free zone also needs “good software:”

- Best practices for all aspects of management and operations (see Appendix D).
- Improved regulatory environment (see the Westgate Report).
- Strong focus on promotion and marketing.
- Focus on exports.
- All staff trained in modern free zone development, especially customer relations.²
- Private sector involvement in free zone development, management, and operations encouraged and facilitated.

² Jose Ceron, Vice President of the San Isidro free zone in the Dominican Republic says, “We devote increasing amounts of time to customer service. Customer service is of the utmost importance because of our need to satisfy our clients in order to keep them as clients, and also because our current tenants serve as our most valuable promoters”. At Shannon, the Free Zone Authority (and the IDA in Ireland as a whole) depend considerably on existing investors for leads on new investors.

- Links between technical education institutions, the investment promotion agency, and the free zone authority.
- A program to facilitate business linkages between local firms and free zone investors.
- Targeting of particular types of investors and designing “software” to meet the needs of that investor (e.g., call center or medical equipment producer) in concert with the investment promotion agency.

Positioning the zone in a business sense will require the promotion agency and zone management to together answer key questions: What type of investor is coming to the zones? What type of investor is the promotion agency targeting? What physical facilities does the investor require? What else do investors require?

In the presentation, “Egypt the Land of Opportunity,” GAFI acknowledges that how free zones are operated and managed must change, and that zones will face new challenges. Changes will include new objectives, greater emphasis on promotion and investor servicing, and simplified procedures.

VISION AND MISSION STATEMENT

The starting point in repositioning Egypt’s free zone program to meet future challenges and contribute to the new economic policy is a clear statement of the program’s vision and mission. The vision should focus on

- A quality product,
- Best practices,
- Export orientation,
- Labor-intensive and technology based projects. and
- Establishing roots in the Egyptian economy.

A possible vision statement is as follows:

To create a free zone regime that matches the world’s best in order to attract major investments in labor-intensive and technology-based business sectors that will develop deep roots in Egypt over time and supply markets in Africa, the Arab World, and Europe.

A mission statement could be as follows:

- To work to create a world-class free zone regime.
- To win for Egypt a significant percentage of mobile export-oriented foreign direct investment in labor-intensive and technology-based sectors.
- To build strong links between free zone industry and the domestic economy.
- To encourage the development and installation of Egyptian managerial talent at the highest levels.
- To encourage links between the technical education institutes and the free zones sector.

PUBLIC VERSUS PRIVATE FREE ZONES

Government-sponsored free zones have had mixed success. In East Asia, they have been successful, except Bataan in the Philippines. Some have been very successful in Korea,

Taiwan, Malaysia, Thailand, and Singapore. The Jurong Town Corporation, a Singapore government company, constructed most of Singapore's industrial space. In the Philippines a number of successful private zones have been developed since 1990 (see Appendix B). In Arab countries, government-sponsored zones have also had mixed success. Jebel Ali in Dubai has been an outstanding success, but zones elsewhere have been much less impressive (Iran, Syria, Jordan, and Egypt). In Africa, the most successful zone (Sameer in Nairobi) is privately owned, and most government-sponsored zones have not been successful. In Mexico and Central America the private sector has been both very active and successful. Developed by the private sector, Mexico's Maquiladora, has 3,600 projects employing 1.3 million workers and exporting \$79.4 billion in goods, with value added in Mexico at \$17.8 billion.

Given the private sector's record in developing zones in all parts of the world and the limited success of government-sponsored zones outside of East Asia, GAFI should encourage the private sector to develop new export-oriented zones in Egypt. GAFI should also examine the possibility of privatizing some or all of functions associated with managing public zones. Appendix C provides more details on private free zones.

The best way to attract private free zone developers is to create favorable political and economic conditions and an effective investment promotion agency that works with developers and that can win the trust and confidence of the private sector (see Appendix B).

ESTABLISHED FREE ZONES

Successful repositioning and development of Egypt's free zones should begin with repositioning of established zones. To close or neglect existing zones would send a very bad message to potential investors and shake the confidence of existing investors, who can be the zones' most valuable promoters. All investors interviewed for this project stated emphatically that they would prefer to be inside rather than outside the zone. The Leoni company is very satisfied with its position in the El Nasr City zone, which is close to the airport and good hotels. As proof of its satisfaction, the company has expanded continuously in the past eight years and now employs about 3,000 workers.

In repositioning existing zones, GAFI should emphasize the export aspect. If possible, investors whose major focus is the domestic market should be removed from zones. Investors stocking motor vehicles or other products for sale in the domestic market contribute little to zone development. If the zones did not exist they would locate elsewhere in Egypt and pay tax on profits as well as import duties and levies at the point of import.

In repositioning zones GAFI should implement the recommendations of Westgate, and bring in design experts to improve the appearance of the zones.

SITE SELECTION AND DESIGN

Site selection, design, and layout will be influenced by the type of investor likely to be attracted to the site. Before selecting a site, the developer should consult with the National Investment Promotion Agency (IPA), which should be able to advise on types of investors and their requirements. Thus the free zone will be sited to provide appropriate accommodation for incoming investors.

Most free zone investors will fit into the light industry category. They will therefore want a clean, smoke-free environment. The site should be level or gently sloping with good access to ring roads and international connections. (A major advantage of Leoni at El Nasr is the proximity of the airport and business support facilities). The site should be free from flooding with good ground bearing conditions and a rectangular shape for economical design. It should have adequate infrastructure services close by and a water outlet for treated effluent and storm water.

The building density (and whether or not multistory factories are permitted) depends on the clientele and the availability of land. Zones dominated by the electronics/medical equipment sectors require low-density development (25 percent of the total area built on) and high standards of landscaping. Where the garment sector is dominant, a higher building density is possible.

ESTABLISHMENT PROCEDURES

Procedures for establishing a private free zone should be simple and straightforward and include the following:

- Feasibility study by the sponsor.
- Environmental impact study.
- Evaluation by the zone authority.
- Consultation with interested parties (customs administration, area planning authority, environmental authority).
- Recommendation to government on (1) the establishment of a new zone and (2) the issuing of a developer's license to the sponsor/developer.
- Decision by government.

ORGANIZATION AND MANAGEMENT

The zone developer is responsible for organizing and managing the private free zone in accordance with the conditions of the developer's license. The developer is responsible for all aspects of zone development and management (e.g., controlling the behavior of investors, maintenance, security, rent collection). The lease governs the relationship between the developer and investor, stipulating that the investor behave as a "good neighbor" and allowing the developer to enter the investor's premises to inspect effluent treatment and disposal arrangements, storage of garbage, dangerous substances etc.

The Free Zone Authority ensures that investors and developers comply with license conditions. The Authority should have no function in the daily operations of the private free zone, and it does not need to issue import or export permits, check stock accounts, or engage in other customs control procedures. In a *public* free zone, the Authority (GAFI) develops and manages the zone, and ensures that investors and the zone management adhere to license conditions.

CUSTOMS ADMINISTRATION

The traditional function of customs is negative—preventing smuggling—or the importation of goods without checking and the collection of various duties and taxes. In a free zone, the task of customs is positive: to facilitate the flow of goods through the zone from and to overseas

destinations. Detailed checking of consignments is not necessary. The emphasis is on documentary control and random inspections of 5 percent of shipments. Goods arriving at ports and airports for free zone destinations should be transferred to the zone unopened and under customs bond. A customs officer with experience in free zones should review Egypt's free zone customs procedures with a view to reducing and simplifying procedures in accordance with best practice and introducing a "customer oriented" culture.

PROMOTION AND MARKETING

Promotion and marketing are essential to zone development. Mobile export-oriented investors of the type that could benefit from a free zone location are strongly influenced by marketing and promotion (see numerous studies and publications by Wells and Wint). Promotion and marketing are expensive. It can cost more than \$250,000 to keep one person in an overseas office. The developer, who will have limited resources, will need marketing support from the Free Zone Authority and the National Investment Promotion Agency

INVESTMENT PROMOTION AGENCY

Wells and Wint studied various formats for IPAs: department of government, state agency with board of directors and considerable operational autonomy, or private sector entity. They concluded that a state agency with a board of directors is the best means for promoting foreign direct investment. Most countries that have successfully promoted investment have used a state agency: Singapore Economic Development Board; Malaysian Industrial Development Authority; CzechInvest, or IDA Ireland. These agencies have very visible support at the highest level in government.

At present, a department in GAFI is responsible for promoting investment. This department should be developed as an agency with a mixed board of directors to guide it. The board, which should consist of up to ten people appointed to their positions, could include senior business executives, high-level government personnel, and people from the technical and higher education sectors. Agency staff should consist of youthful executives with business experience. These executives should be guided by experienced investment promotion personnel.

TRAINING

All GAFI and customs personnel should be trained in key aspects of a modern free zone regime. The training should cover all aspects of free zone best practices, team work, marketing, client liaison, and customer satisfaction. The free zone customs administration will need special training that could be delivered by a customs person with extensive "modern" free zone experience. The course should cover (1) modern customs thinking, with emphasis on facilitating trade and documentary control rather than inspecting goods; and (2) updating customs procedures in Egypt's free zones.

5. Conclusions and Recommendations

Successful free zones can contribute significantly to a country's employment and foreign currency earnings. Over the past 30 years, employment and net export earnings generated by Egypt's free zones have been poor in comparison to successful Asian free zones. However, current conditions in Egypt, with the outward orientation of economic policy, are ideal for using the free zone formula—and the country's cost, transport and other infrastructure and general investment factors compare favorably with those of its neighbors. In addition, Egypt's free zones have had a number of successes in recent years (e.g., Leoni), showing that foreign investors can compete well in international markets.

The following steps are recommended in pursuing the use of free zones in Egypt:

1. Improve the zones and market them effectively.
2. Streamline zone organization and procedures per the Westgate Report, simplifying customs procedures and developing a "customer friendly" attitude.
3. Make GAFI's promotion and marketing department a full fledged investment promotion agency, modeled on successful agencies in Europe and East Asia. In its early years, the agency should have adequate staffing and financial resources and be supported by experienced investment promotion practitioners.
4. Where possible, adopt a policy of privatizing all or part of the existing free zone management and operation and encourage the private sector to develop new zones.
5. Streamline GAFI organization and procedures as per the Westgate proposals.
6. Have an experienced customs officer review customs free zone operations and procedures.
7. Arrange training programs for all GAFI and free zone customs personnel.

Appendix A. Statistical Profile of Egypt's Free Zones

Table A1 outlines the growth of free zone projects, public and private. Of 848 projects, 660 are in public sector zones and 188 are in private sector zones. As of August 31, 2005, 636 projects were operating. In 1997, about 40,000 people were working in public sector zones, rising to 55,000 in 2003 and 103,000 in 2005.

Table A1
Project Growth

Category	1989	1992	1993	1997	2000	2003	2005
Industrial	87	130	147	167	393	378	469
Storage	138	197	231	405	252	154	222
Service	33	38	46	17	140	177	157
Total	258	365	424	589	785	709	848

SOURCE: GAFI slide presentation and files.

The following tables present details on employment by zone and sector; on investment by sector and source; on the value of imports of raw materials and other goods for resale; the value of the exports of goods; the sale of goods into the domestic market; on types of industrial exports; and on the destinations of exports.

Table A2
Employment by Zone and Sector on June 30, 2003

Zone	Garments	Metals/ Engineering	Petroleum	Other	Total
Damietta	60	50	2,270	315	2,695
Suez	-	3,172	24	1,432	4,628
Ismalia	4,183	79	15	300	4,577
Port Said	8,145	1,185	425	887	10,642
Nasr City	13,324	2,200	352	3,746	19,622
Alexandria	4,511	2,108	752	2,545	9,816
Media City	-	-	-	3,115	3,115
Total	30,223	8,794	3,838	12,340	55,195
Percentage (%)	55	16	7	22	100

SOURCE: GAFI.

Table A3
Investment by Sector, 2004

Sector	Percent of Total
Petroleum	66
Metals/ engineering	16
Garments	10
Other	8
Total	100

Source: GAFI.

Table A4
Sources of Investment (in \$b)

Source	2000		2002		2004		2005	
	Value	Percent	Value	Percent	Value	Percent	Value	Percent
Egypt	2.8	78	4.1	79	5.1	75	5.4	75
Foreign	0.8	22	1.1	21	1.7	25	1.8	25
Total	3.6	100	5.2	100	6.8	100	7.2	100

Source: GAFI.

Table A5
Source of Foreign Investments, 2004

Source	Percentage
Europe	61%
Arab Countries	31
United States	4
Other	4
Total	100

Source: GAFI.

Table A6
Value of Imports, Exports, and Sales of Goods (\$ Billions)

Category	2000	2001	2002	2003	2004	Cumulative
Exports	0.6	0.9	1.2	1.5	2.3	6.5
Imports	0.9	1.4	1.2	1.3	2.0	6.8
Balance (Ex-Im)	-0.3	-0.5	-	+0.2	+0.3	-0.3
Domestic market sales	0.5	0.9	1.1	1.3	2.2	6.0
Total sales	1.1	1.8	2.3	2.8	4.5	12.5
Exports as percent of total	55	50	52	54	51	

Source: GAFI.

Table A7
Industrial Exports by Category, 2004

Category	Percent of Total
Petroleum	45
Garments	21
Metals/ engineering	17
Other	17
Total	100

Source: GAFI

Table A8
Exports by Destination, 2004

Category	Value (\$b)	Percent (%)
Europe	1.3	58
Arab countries	0.5	20
United States	0.3	14
Other	0.2	8
Total	2.3	100

Source: GAFI.

The following are details on the GAFI information sources:

- Egypt: The Land of Opportunity (PowerPoint presentation)
- Egyptian Free Zones Overview, by Eng/Mohammed Abdul Rehim, Head of Free Zones Sector (PowerPoint presentation)
- Free Zones Position on 31-08-2005 (GAFI statistics document)
- GAFI statistics document with information up to 30/6/2003
- Development of Free Zones in the ESCWA Region. New York: United Nations, December 1994.

Appendix B. Philippine Free Zone Development

Located south of Taiwan and north of Indonesia, the Philippines has a tropical climate, an area of 11,600 square miles spread over 7,000 islands, 900 of which are inhabited, and a population of about 60 million. The capital, Manila, has a population of about 6 million. About 90 percent of the population can read and write. A significant percentage of Filipinos are college educated. The country has two official languages, English and Filipino or Tagalog. Most people speak English fluently. The system of government is modeled on the U.S. system, and business and cultural practices follow the American pattern. Infrastructure is reasonably well developed, particularly around Manila, although there are some power supply problems, especially in dry months, as much of the electricity is hydrogenerated. Agriculture is the main source of employment, followed by services and industry, including manufacturing, mining, and construction.

The Government of the Philippines established three export processing zones in the 1970s: Bataan in 1972, Baguio and Mactan in the late 1970s, and Cavite near Manila in 1986. In the 1990s private free zones expanded rapidly. The government approved 80–100 zones and about 50 have been established. Bataan has been a spectacular failure, while Cavite and Mactan have been successful, and Baguio can be regarded as somewhere between.

EPZ PROGRAM HISTORY

The program began with the publication of Presidential Decree No. 66, creating the Philippine EPZ Authority, and designating 1,600 hectares in Mariveles, Bataan, as an EPZ. Of the total, 310 hectares was for housing and commercial activity, 160 hectares for a future airport, and the balance of 1,130 hectares for industrial activity. It was envisaged that employment in zone enterprises would rise rapidly, and exports were projected to reach more than \$300 million per year. Light, medium, and heavy industries were planned for Bataan, including clothing, electronics, machinery, shipbuilding, and ship repair.

In the late 1970s, two more zones were established at Baguio and Mactan. The Baguio zone was about 69 hectares, and Mactan had 119 hectares. The emphasis for both zones was light industry. Both are close to airports. The airport at Baguio is a domestic landing strip; Mactan is 1 km away from Cebu International Airport. A fourth zone—Cavite, 30 km south of Manila—opened in 1987. It has an area of more than 300 hectares.

Bataan

Bataan, the first site chosen for EPZ development in the Philippines, is about 150 miles by road from Manila (2 to 3 hour drive), in a relatively isolated mountainous area. The nearest

town is Mariveles, with a population of 10,000. Bataan is about 1.5 hours by boat across the Bay of Manila. The planned area of the zone was 1,600 hectares. The feasibility study envisaged that Bataan would attract light, medium, and heavy industry—unlike most free zones that focus on light industry. Employment, according to the study, would rise from 8,000 in 1974/5 to more than 50,000 people in four years.

Bataan was conceived as a major Philippine industrial and international trading center. The development plan set aside more than 500 hectares for industrial development, of which about 170 hectares has been developed, and more than 1,000 hectares for green areas, housing, and commercial uses. About 200 hectares of this was developed. The commercial housing and development included about 800 houses, apartments, and dormitories for about 4,000 people. Most of the housing and dormitory space is occupied. Nearly half of the houses are rented to free zone authority employees.

Bataan attracted some worthwhile investors in the early years. The Ford motor company established a stamping plant and BASECO established a shipyard. Employment peaked around 1980 at 21,000. Since then the zone has steadily declined and now employs only 10,000 people. It has continually lost money. The infrastructure is in a very poor state. Roads are poor; drains are badly maintained and often clogged; half the water is “unaccounted for” due to leaks, illegal tapping, and poor metering; many sewers are clogged. A sewage treatment plant was built in the mid-1980s. The existing sewerage flow is too small to drive the plant. It has never been used. The main sewer bypasses the plant and flows directly into the sea. All of this is the result of very ambitious demand projections not being realized.

Mactan

The Mactan EPZ is close to Cebu and next to an international airport. Cebu is the third city of the Philippines, after Manila and Davao in the south. With a population of about 0.5 million, it is a major commercial and tourist center very popular with Japanese tourists. The international airport has daily flights to Tokyo, has a major container terminal, and offers regular services to most key destinations of the Far East.

The EPZ is located across the river from the city and has developed rapidly, attracting a number of good international companies, including Timex, NEC, National Semiconductor, and United Technologies. The feasibility study for the zone was completed in 1977. The target was to employ 30,000 on 120 hectares in airfreight-oriented light industry. The problem facing the zone is supply rather than demand. At present, most of the zone is fully developed, and nearly 30,000 people work there. In the early 1990s, funds for further development of Mactan fell short because most Zone Authority resources were devoted to trying to fix problems at Bataan.

Baguio

Located in north central Luzon, about 180 miles north of Manila at an elevation of about 5,000 feet, the city of Baguio has a very pleasant climate all year round. It is a favorite destination for residents of Manila, who want to escape the heat of the city. The zone was established in the late 1970s on a site of about 100 hectares. Baguio and Mactan are very similar: both are tourism as well as commercial centers and both are near airports, although

Baguio's airport is domestic. Baguio is about a 6-hour drive from Manila, which has the country's main port and airport.

Like Mactan, Baguio has suffered from supply rather than demand problems. The demand for space in Baguio is not as strong as in Mactan. Texas Instruments is the main investor in Baguio. An Italian leather company is also located there. In the late 1980s, progress in Baguio faltered because of problems with infrastructure, land availability, and squatters. In July 1990, an earthquake struck, collapsing some multistory factories and killing people.

Cavite

The Cavite zone is the most recent of the four government zones. Established in the mid-1980s, it is located about a one-hour drive south of Manila and covers a couple of hundred hectares. Because of its proximity to Manila, it is expanding fast. Like Baguio and Mactan, progress in the early 1990s was delayed because of a lack of investment zone funds. In the 1990s it developed rapidly.

ASSESSMENT

The Philippines has considerable potential for industrial development. It is well placed in the Asia-Pacific region, close to Japan and Taiwan, two major centers of outward investment. It has many close cultural and business ties with the United States, and an educated and English-speaking workforce, unlike Thailand or Indonesia. Yet, until the last decade or so, the Philippines lagged far behind other Asian countries in industrial development. Political difficulties, government policies, a difficult financial situation, a strong protectionist lobby, excessive bureaucracy, and corruption combined to impede development. This changed in the 1990s; in the past decade, the country has experienced a significant inflow of investment and rapid expansion of the economy.

EPZ development was impeded by the very poor location of Bataan. The large bureaucracy also drained resources, hindering the promotion and development of well placed zones at Cavite, Mactan, and Baguio in the 1980s—all of which had considerable development potential. In the 1990s Filipino private developers responded to the improved investment climate by developing high quality EPZs geared to accommodate prestigious international investors in attractive locations in and around Manila.

Appendix C. The Private Sector and Property Development

Like other business activities, success in property development depends on an accurate evaluation of supply and demand. But property also has characteristics that make its development very different from other forms of business. It is heterogeneous, which makes price and other comparisons between different properties difficult; it is illiquid, so cannot easily be turned into cash. And property is slow to sell for a number of reasons. Appraised price is only an estimate of market price, which in fact is unknown. Because the market is heterogeneous, it might take time to find a buyer. When a buyer is found, purchase negotiations can be complex. Any major property transaction must cover a range of issues, including financing, repairs, and contingency claims. Transaction costs are relatively high (5 percent to 10 percent of property value). Market information may be lacking; even in the most advanced property markets, information is limited. Ideally, property investment decisions should be based on detailed, quality information. A property is usually a large-scale and indivisible product. There is considerable government intervention in the market. The supply response in the short-term in the property market is extremely inelastic.

Despite these negative characteristics, *good* property investments have performed well over the past 20 years. Property is a good hedge against inflation. Investing in industrial property is regarded as riskier than investing in retail or office developments, and investment in new projects in the planning stages poses more risk than completed projects with a good list of tenants on long leases. Property investment is unique in another sense. Many strategic decisions are made at the outset and are largely irreversible. The location of a property investment is fixed.

Two groups must be satisfied in any private decision to develop a piece of land as an industrial park: developers and financiers. Developers and their advisers put the project together, and financiers (i.e., banks, investment funds, property companies) decide whether the investment compares favorably with other opportunities (i.e., investment in guilds and equities). Developers must be convinced that the property is worthwhile, and that the right type of financing is available. They need long-term capital with a good balance between debt and equity. A riskier investment should have a relatively low gearing. Short- or medium-term financing may lead to problems if or when the project needs to be refinanced.

Developing new property is much riskier than investing in existing property. With existing property all strategic decisions are made. Supply and demand are clear. The new investor may

see new ways to boost the occupancy rate or reduce management expenses. If most of the property is released to reliable tenants on long-term leases, the business risk is low. In any property transaction the quality of leases must be evaluated properly.

The successful development of new property, especially industrial property, requires exceptional judgment. A reliable evaluation of supply and demand is essential—and this evaluation must be made in a market where knowledge is far from perfect. The developer must be a good project manager, able to select and acquire a site in a suitable location, assemble various elements, and manage the project.

Because of the high risks involved in property development, private developers, who must make a profit, will invest only where demand for space is proven and large-scale. This is particularly true for industrial property, because of the higher risks involved. Private industrial property development is concentrated in or around larger economically active towns and cities. In the industrial property sector, investment is concentrated in sections of the property market where demand is strongest, and where buildings can be leased to a wide variety of users. General industrial estate development that can accommodate a wide range of warehousing/distribution and light manufacturing, is one sector. Business park development, in the right location, is another sector popular with private developers. Free zones in the right location will also interest private developers.

Projects that are primarily developmental (e.g., incubator units, science parks, technology parks) usually do not attract private funding and must be funded from public sources or philanthropic foundations.

Appendix D. Best Practices for Free Zone Development and Management

ELIGIBILITY

A free zone or export processing zone is a special or privileged area where exceptional conditions prevail (e.g., tax holidays, duty-free importation). It follows that only investors who meet certain criteria are admitted to the zone. Criteria relate to the objectives of the free zone program. In Egypt, those objectives include employment creation, export growth, and technology transfer.

In a well planned free zone, catering to electronics, healthcare, clothing etc, polluting investors are not admitted. An export processing zone should emphasize exporting. The investor should have “good financial standing” and a plan to export most output. Allowing manufacturing or trading where most output is sold on the domestic market could prove counterproductive. Businesses that focus on the domestic market don’t need the incentives and privileges of free zones to encourage them. It is likely that customs controls would be stricter than they might otherwise be if there are domestic market sales on a major scale. Projects that generate significant employment or contribute to technology or the development of management or technical skills, in addition to exporting, tend to be highly valued.

SITE SELECTION

A good location is the first step in any successful property project. The first step in site selection is a clear understanding of potential customers. Customers have different requirements. Export investors will want to be close to international transport facilities. An investor with a low technology, labor-intensive activity will want to be near large numbers of unskilled people seeking work. An investor using a high level of technology will probably want a site in a pleasant environment close to an airport. The areas around most of Europe’s major airports are heavily populated with expensive business parks.

A technology park does not necessarily need to be near a university campus, but it should be near a research and training institution, a qualified workforce, and international transport. It should also project a positive image and offer excellent telecommunications, a pleasant environment, and a flexible and supportive bureaucracy. A large area of land must be available and zoned for industry, and strong government support at the local, regional, and national levels is also important.

Most free zones and business parks are beside large population centers, close to major highways and with ready access to an international airport. The El Nasr City free zone has these characteristics, which proved to be major considerations for Leoni. In the last 20 years business parks along the M25 motorway near London, with easy access to Heathrow and Gatwick airports, have grown rapidly. The areas near Schipol in Amsterdam, near the Frankfurt airport, and near other major European airports have all experienced rapid growth in business parks. The private sector developed almost all these parks.

An ideal site should be rectangular for economical design. The site should be gently sloping to facilitate drainage and should have good infrastructure services close by to avoid large offsite investment. If the main investors are manufacturers, the water supply should be 50,000 liters per ha per day; in commercial parks about 15,000 liters per ha per day will be adequate. For a major water-using industry (e.g., textile plant) water requirements can increase dramatically. The electricity supply should be around 250kva/ha. The site should be free of flooding, contamination, and land tenure problems. It is important that these problems be checked thoroughly at the outset. Contamination can be a serious problem in many former East Bloc countries. Western investors are often very sensitive about contamination because of possible liabilities. The site should be in a clean pleasant, dust-free environment where the target investors are involved in medium/ high technology. Very often when available sites are checked out against the ideal site the choice is very restricted.

SITE DESIGN AND LAYOUT

Design and layout will depend on the type of investor. Other factors, such as scarcity and cost of land, are also important. If the developer is hoping to attract “high quality” clientele then a high standard of building design and landscaping and relatively low building density is desirable. If the site is in an urban area, high building density and multistory buildings will be acceptable, provided high standards of design and landscaping are maintained.

In a more traditional industrial/warehousing estate or free zone, cost is important. Limited landscaping and relatively high density are desirable. In larger estates that might have different types of investors zoning may be important. Maximizing the use of space—and revenue and profitability—requires the skills of an experienced planner.

Road layout is the starting point in any site design. A grid system is usually best. Main roads are normally 10 meters wide with secondary roads 7.5 meters. Good turning circles are important to accommodate modern container traffic. In most cases, the road network should not occupy more than 15 percent of the site, but the network might increase to 25 percent on a very badly shaped site. The road network should be installed in phases. The planner should retain as much flexibility as possible for as long as possible. The design should allow for easy installation and maintenance of water, sewage, storm water, telecommunications, and electricity services along the side of the road.

Proper provision for car, truck, and bus parking should be made. There is no standard formula for determining the ratio of parking space. Key variables are the quality of the public transport, the culture with regard to transport, location, and income level.

PHASING OF DEVELOPMENT

Development should be phased in line with conservative demand projections for three reasons. First, the cost of developing land (i.e., installing roads, drainage, infrastructure) is high. Developed land that is not being used is an investment producing no return. An investment of this nature (if it is idle for a long time) will lead to repayment difficulties, cash flow problems, losses, and failure.

Second, phasing serves promotional purposes. Investors do not want to operate in a building site. They want a completed estate. Ideally, each phase of a development should be completed and fully occupied in 2 to 3 years. Landscaping should begin as soon as possible. Building traffic for the second and subsequent phases should be routed around the completed first phase. Third, phased development retains flexibility. The developer can change layouts to accommodate new demands in later phases.

Conservative demand projections should be used in planning the size of each phase. If projections are too low the next phase can be accelerated—but if projections are too ambitious development cannot be scaled back once construction begins.

Many ambitious development plans have ended in failure. Large industrial estates with infrastructure in place remain idle for years; money to repay loans does not materialize; cash flow is restricted; maintenance is scaled back; infrastructure deteriorates; water mains start leaking; and street lighting is vandalized. The whole development goes into a downward spiral. In some estates the scale of infrastructure installation far exceeded demand and was never used.

PARK MANAGEMENT

The skills and management requirements for developing a free zone industrial park are very different from those for managing an established park. Development emphasizes design, project management, promotion and marketing, and supervision of construction. This then changes to administration and operational tasks, such as security and maintenance. These changes in management requirements from planning through construction to operation highlights the need for organizational flexibility. Such flexibility can best be achieved by using consultants and contract staff, rather than a large permanent technical staff.

Ireland's Industrial Development Authority and Shannon Development both believe strongly in using consultants for industrial park planning, design, and construction supervision. The technical workload fluctuates considerably over time and such fluctuations in manpower demand can best be accommodated by using consultants. Using consultants also gives an organization access to a very wide range of expertise and experience. A good firm of engineering consultants will have specialists in various aspects of infrastructure design, roads, structures, etc. No park development organization could hope to employ such a wide range of experts.

Many routine tasks related to the operation of free zone industrial parks (e.g., maintenance, security, garbage disposal) are also handled by private contractors. There are two reasons for this. Both the IDA and Shannon Development want to minimize the number of people involved in park administration, as their main task is investment promotion. The workload in relation to these activities fluctuates throughout the year, and these fluctuations are more

easily managed by a relatively small-scale private sector organization that specializes in this type of work.

There is a good argument for having a small administrative group responsible from the beginning for all aspects of the park's development and operation.

LEASE AGREEMENTS

Free zone industrial estate or park sites are normally leased rather than sold. Buildings may be leased or sold but the site on which the building is constructed is leased. The lease document is the basis for the relationship between the investor (lessee) and the estate management (the lessor). The important points in any lease document are as follows:

- ***The property:*** the property to be leased should be clearly specified in a map and a description of the property attached to the lease. It is important that this map and description be accurate.
- ***Term and rent:*** the term of the lease (how many months or years and the termination date) should be set out as well as the amount of the rent (monthly, quarterly, annual) and the payment days.
- ***Undertaking:*** there should be an undertaking from both the lessor and lessee to comply with all conditions of the lease.
- ***Right of Entry;*** it is important that the lessor be able to enter the property at all reasonable times to maintain infrastructure or inspect the property. Obviously, the lessor should use this right with due consideration for the lessee.
- ***Rent review:*** most long-term leases now contain provisions for a rent review. (This means, in effect, a rent increase). In the case of Shannon there is provision for a review every five years. In other leases the review may occur every three years. The rent review clause should set out the procedures and provision for arbitration if the lessor and lessee cannot agree on a new rent.
- ***Unpaid rent:*** The lease should set out procedures and consequences if the lessee does not pay rent when due.
- ***Other charges and taxes:*** the lessee is usually obliged to pay other charges and taxes (e.g., property taxes to the municipality, charges for water and electricity, and possibly a service charge to cover the cost of security and the upkeep of the estate—road sweeping, grass cutting etc). This obligation should be specified in the lease.
- ***Laws and regulations:*** a good industrial estate is one where all investors behave as good neighbors and obey the law. There should be a clause that obliges the lessee to adhere to laws on planning, the environment, pollution, and factory conditions.
- ***New structures or alterations to existing structures:*** the lease should provide that the lessee obtain permission from the lessor for alterations to existing structures or the construction of new structures. The lessor should respond positively to reasonable requests.
- ***Maintenance of the property:*** responsibility for maintaining the property and repairs should be clearly stated. There are three basic options: (1) the lessor is responsible for all repairs; (2) the responsibility is divided (e.g., the lessor responsible for outside

repairs and the lessee responsible for repairs inside the building), or (3) the lessee is responsible for all repairs. Repairs include normal “wear and tear” to a building. If, for example, a structural crack appeared in a building the lessor would normally be responsible—unless the crack was caused by the lessee’s negligence.

- **Connection to infrastructure services:** There may be a clause dealing with these issues.
- **Pollution, waste and effluent disposal, smoke emissions and environment protection:** Most leases now include clauses on environmental issues. The lessee should comply with regulations on the estate as well as any new regulations or environmental legislation.
- **Insurance:** it is important that the lessee be covered by proper insurance in case of accidents to workers, members of the public, or others visiting the property. The lessee should also be covered against fire or storm damage
- **Fire Fighting equipment:** t proper fire fighting equipment should be on the property. Responsibility for providing this equipment should be clearly stated.
- **Dangerous materials:** proper storage of dangerous materials is important
- **Use of the property:** the lease should state the purpose for which the factory can be used (e.g., industrial production, storage, warehousing).
- **Sublease or transfer of the lease:** there should be a clause stating whether or not the property (or part of it) can be subleased by the lessee. The lease should also cover the issue of the transfer of the lease to another lessee
- **Termination of the lease:** the lease may contain a provision for terminating the lease before the end of the lease period with the agreement of both the lessor and lessee. There may also be provisions for termination at the end of the agreement
- **Lessor’s guarantee:** subject to the conditions of the lease the lessee should be able to use the premises without interruption or interference from the lessor

Supervision of Conditions of Lease

A core activity of any free zone or industrial estate management is supervising lease conditions. Much of this work may be undertaken by maintenance staff who will identify problems and the source of problems during the course of their work (e.g., illegal disposal of effluent into sewers; storage of dangerous materials; disposal of refuse; smoke emissions). The normal practice is for the maintenance staff to report a problem to the section or person responsible for supervising lease conditions. The free zone or estate management should try to solve the problem with the lessee on an informal basis. If this fails, the management may resort to legal or other sanctions or methods.

MAINTENANCE

Maintenance has three aims or functions: (1) to maintain the assets of the industrial estate developer in good condition; (2) to provide a good service to investors; and (3) to attract new investors. The management sometimes neglects maintenance because of a lack of foresight or a lack of money, or both. Often, when budgets are tight, the maintenance budget is the first to be cut. Minor repairs are postponed and sometimes turn into major, expensive repairs. For

example, a water tank that is not painted regularly will rust and decay and have to be replaced earlier than it would otherwise. Burst water mains will result in a loss of water and possibly a reduction in pressure. In one free zone industrial estate, 50 percent of the water is lost through leakage.

A good maintenance program in a free zone or industrial estate begins at the design and planning stage. Slightly more expensive materials can result in significantly less costly maintenance over time. PVC windows, for example, may be more expensive than wooden windows but do not need regular painting. Corrugated asbestos cement roof sheeting is relatively inexpensive, but becomes brittle with age and difficult to repair. It is important therefore that the estate designer and the financial advisors understand the full implications of using certain materials.

Good communication between maintenance and design personnel can also reduce or eliminate maintenance problems. At Shannon, for example, an expansion joint in the factories allowed water into the factory. Communication between the maintenance and design personnel led to an improved design and elimination of the problem.

Maintenance Activity

On an industrial estate, maintenance covers

- Buildings;
- Landscaping (keeping lawns cut and edged during the growing season, caring for trees and shrubs, removing debris and litter);
- Roads, footpaths, and car parks (regular sweeping, gullies cleaned);
- Street lighting (replacing bulbs, repairing cables)
- Sewers, drains, and culverts (inspecting for oil and chemical spills and taking remedial action, removing blockages).
- Water supply (ensuring continuity and consistent quality, monitoring regularly and taking remedial action where, repairing burst pipes, reading and repairing meters, inspecting valves and fire hydrants).
- Pump houses (ensuring that pump houses for sewer and surface water are working properly so that public health is protected and flooding problems are avoided).

Responsibility for Maintenance

Industrial estate management will normally be responsible for maintaining common areas and infrastructure. Sometimes the utility supply companies (water, telecommunications, or electricity companies) may take responsibility for maintenance. With regard to buildings owned by the industrial estate company there are three options:

- **Full estate management repairing lease.** The estate management is responsible for all repairs, including cleaning, heating, and lighting. This type of lease is normally used only where developers lease office accommodation to a number of tenants. It is rarely used where factory accommodation is concerned or where one tenant leases a entire office building.

- ***Partial repairing lease.*** The industrial estate management is responsible for part of the maintenance (usually the outside of the building) and the tenant is responsible for interior maintenance. This type of lease can work well in a large industrial estate. It ensures that the exteriors of factory buildings are maintained to a common standard. The estate management can ensure a good overall appearance. In a large estate there may also be scale economies in having one workforce maintain a group of buildings close together.
- ***Full investor repairing lease.*** The third option is for the investor to take full responsibility for all repairs and maintenance. The estate management is relieved of maintenance responsibility, but does not have the same degree of control of the estate's appearance.

Organizing a Maintenance Program

Maintenance is preventive or corrective. Regular inspections of buildings and infrastructure can identify many problems before they become serious and ensure that repairs are relatively inexpensive. Preventive maintenance includes regular painting of woodwork and rodding of sewers. But not all problems can be foreseen. It is not possible to forecast when a window will break or a storm will strip a roof from a building. Much corrective maintenance must be done on an emergency basis.

Most preventive maintenance can be planned in 3 and 5-year periods. Ideally, the amount of preventive work should far exceed the amount of corrective emergency work. Long-term preventive maintenance is easy to forecast and provide for in the annual budget. It also involves minimum disruption.

An important issue in organizing a maintenance program is the organization of the workforce. There is not an even workload throughout the year. Much preventive maintenance occurs in the summer. Most landscaping (e.g., grass cutting) occurs in the summer. It is impossible to employ a full staff on a year round basis. Some work will have to be contracted out. Some estate managements contract out all the work and maintain a small supervisory staff. The two basic forms of maintenance contract are

- ***Lump sum contracts*** for specific jobs, such as a major repainting scheme. This contract is suitable when the task can be clearly specified in advance.
- ***Time and material contracts***, which are suitable for jobs where details cannot be specified in advance. The normal practice is to seek tenders by means of a schedule of rates for labor and equipment. The estate management can supply materials or the contractor can be reimbursed on the basis of invoices.

FREE ZONE OR EXPORT PROCESSING ZONE

Some special considerations apply to free zones, particularly in developing countries. Many export investors in industrial parks are from overseas, and import raw materials for processing and export. They can choose among different countries and locations within a country. Therefore, they are strongly influenced by the investment climate, incentives, and the promotion campaign of the country or region. The investment climate includes a favorable attitude toward foreign investment and export development, a competition exchange rate, the

absence of serious bureaucratic problems, and a customs regime that facilitates the importation of raw materials and equipment for processing and export.

Incentives are financial inducements (e.g., tax exemptions, low interest loans, cash grants) offered to investors, sometimes with conditions, to invest in a country or region. Removing bureaucratic or other obstacles should not be regarded as an incentive, but simply the removal of disincentives. Incentives should not be used to compensate for serious deficiencies in the investment plan. A tax holiday, for example, will not compensate for a poor transport system, which leads to losses for investors.

A good promotion organization can greatly influence an export investor. The best format for a promotion organization is a parastatal organization that can (1) interact with investors in a private enterprise manner with speed and efficiency; and (2) speak with authority on behalf of the government.

The impact of a positive investment climate can be seen in the Philippines, which has enjoyed a major expansion in the number of export industrial parks over the past 10 years—nearly all of which were developed by the private sector. In the 1980s, the country had four state-owned free zones; today more than 100 export industry parks are near major cities, attracting large volumes of good quality export investment.

The impact of a competitive exchange rate was very evident in the Dominican Republic, and Mauritius, in the mid 1980s. Both countries experienced a major expansion of free zone exports following devaluation.

The impact of incentives is not always easy to evaluate. However, there is clear evidence that incentives do influence location decisions when all other things are equal. Ireland is probably the most successful country in Europe in attracting foreign export investment. As a small island at the edge of Europe, it has serious location disadvantages. Yet, with 1 percent of the population of the EU, it has attracted more than 30 percent of American technology investment in Europe. Why? The country is English speaking, has a strong Irish-American influence, a young, skilled, workforce, and a low tax regime. Successive governments have gone to very considerable lengths within the EU to protect Ireland's low tax regime.

Nearly all countries that have attracted foreign export investment have powerful parastatal promotion agencies, with serious budgets, professional management, flexible operating rules, and the ability to speak with authority on behalf of the government (e.g., the Singapore Economic Development Board; MIDA in Malaysia; the BOI in Sri Lanka). The IDA in Ireland and the SDA in Scotland, are two examples of successful promotion agencies in Europe. In the past decade or so, Wales has been very successful in attracting foreign investment. This success has coincided with the emergence of the Welsh Development Agency as a dynamic, promotion organization.

Efficient, duty-free importation of raw materials and equipment is a very important part of any export industrial park. A number of customs formulae permit duty-free importation: free zones, duty-free license schemes, bonded manufacturing schemes, duty drawback schemes. But what matters is the speed and efficiency of the customs administration, not the formula. It is essential that due care and attention be given to customs administration in any free zone industry park plan. Traditionally, customs officers have preventive attitude or outlook. They

check documents, prevent smuggling or illegal importation, etc. A free zone requires a different attitude. The objective should not be to prevent, but to facilitate the flow of goods. Minor documentary errors should be corrected after goods are released. The emphasis should be on balancing stock accounts and sample inspections. Goods should be cleared in a matter of hours, something essential for “just in time” deliveries. A number of countries have gone to extreme lengths to improve their customs administration. In the mid-1980s, Mexico replaced 3,000 customs administrators on the U.S.-Mexican border. In Indonesia, where export investors could wait for weeks for containers to be released, SGS was brought in to manage the customs administration.

Another important element in a free zone, especially a new one, is support for the investor. An investor new to the country will need advice in dealing with the bureaucracy, securing permits, finding accommodation for expatriate workers, recruiting workers, deciding on appropriate paying conditions, etc. Most successful export industry park operators stress the importance of satisfied customers. Misunderstandings and labor unrest can often arise if the investor is not advised properly on labor or agricultural practices. One of the most important individuals in the Shannon zone in the 1960s was the one who advised incoming investors on all aspects of labor recruitment and relations. He often mediated potentially serious labor disputes. Today the need for such a service is more limited. Workers and unions are familiar with foreign investors, and investors can recruit from a large pool of experienced Irish personnel managers.

An extreme example of supporting investors is the Nogales Shelter Plan in Mexico, where the park operator supplies the factory building, labor, and customs clearance services. The investor supplies the raw materials, equipment, and technical supervision.