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FRAMEWORKS CORRELATED WITH EXPORT PROCESSING ZONE SUCCESS

For dozens of countries, Export Processing Zones have provided substantial gains in employment, balance of payments, technical skills transfer, and policy reform implementation. EPZs and related regimes (notably freeport policies) have been central to the export success of Taiwan, Korea, Malaysia, Hong Kong, and Singapore, as noted in LAC/CDIE Paper 1, "Contributions to Development."

Although several Latin America and Caribbean countries in the past decade have become pacesetters and exemplars of EPZ development success, the region has also has had its share of disappointments. In Costa Rica, two government-owned zones have struggled with minimal success to attract investors to remote regions. A public sector EPZ in Guatemala has floundered financially because of its initial rush to complete construction of the entire zone, rather to than phase development in step with demand. Conversely, Jamaican, Dominican Republic, and Uruguayan authorities at times have proven unable to arrange construction of needed buildings on a timely basis, resulting in waiting lists of two years or more to take occupancy in some public sector zones. In the Dominican Republic, problems with unreliable utilities have only been partially surmounted by recent Government decisions to allow alternative provision of telecommunications and power. Perceptions of unreasonable negotiating delays over lease terms at the Puerto Cortes zone in Honduras have cost the country a number of prospective investors, and lax Customs administration of zones in Brazil and Panama has resulted in substantial smuggling of products into the local economy. On a region-wide basis, government-owned zones have repeatedly set lease rates far below levels needed to provide acceptable building maintenance and user services. Many Far East firms operating in Latin American and Caribbean free zones have experienced labor unrest, as a result of poor understanding of local labor/management styles and cultural factors. And few zone industries in the region to date have established "backward linkages" to the economy comparable in extent with those now regularly found in the EPZs of the Far East.

Throughout the world, a common feature of successful free zone regimes has been a national commitment to removing legislative, regulatory, and institutional constraints holding back EPZ enterprise -- optimally, in conjunction with extending EPZ-like incentives to firms operating outside of the zone boundaries. Individual free zone project success, however, also requires site specific efforts to avoid or overcome problems with location, infrastructure, labor recruitment, freight services, and other services and amenities.

This paper begins with an overview of a strategy that has proven effective both globally and in the region, and then examines in detail programmatic approaches and project-level commitments that that may be particularly transferable to Latin American and Caribbean countries desiring to maximize EPZ contributions. It concludes with a review of how EPZs may be more coherently integrated with programs to strengthen nontraditional exports from sponsoring countries.

I. OVERVIEW OF STRATEGY

Free zone success requires commitments at two levels: at a programmatic level, to develop and promote a competitive national free zone regime; and at a project level, to ensure needed site-specific improvements. Programmatic commitments normally are forthcoming from the national government, while the project commitments increasingly are now the responsibility of the local and/or foreign private sectors.

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Program Commitments. The most important element of the free zone program is transparent access by private firms to free zone incentives -- in essence, automatic and timely approval of investment projects meeting simple qualifying criteria. The major users of free zones globally are small and medium sized industries, often with minimal experience in doing business abroad. Uncertainties regarding eligibility and delays in gaining access to incentive regimes in many countries are the foremost deterrent to private sector expansion, both by local and foreign firms. In contrast to Singapore and Hong Kong, where firms can register to do business in an afternoon, private investors perceive Latin America and the Caribbean as a region to be fraught with delays and uncertainties in obtaining approval to do business. A key asset of free zone regimes is their communication to investors that transparent and predictable conditions for business growth will apply in the designated area.

A second crucial element at the programmatic level is the substance of the incentive package itself. To be internationally competitive, a sponsoring country should be willing to provide free zone legislation and implementing regulations that exempt export-oriented firms from Customs Duties on imported items; remove or greatly reduce business taxes; allow for free exchange and control of foreign currencies; provide guarantees against nationalization, ameliorate inflexibilities in labor codes and work visa policies; and allow for private sector provision of many basic utilities and services.

Beyond these factors, credible institutional arrangements are also important to follow through with the promised benefits. However attractive on paper may be the qualifying process for, and substantive nature of, export sector incentives, their positive effect can be partially or fully offset by prevailing hostility or inertia in implementation on the part of the responsible bureaucracies. In the absence of a user-sensitive and well-disciplined tradition in the public sector, countries can gain credibility regarding institutional implementation by adoption of performance-linked reward systems within the public sector to promote, among other activities, efficient Customs clearance and Central Bank procedures relating to EPZ developers and tenants.

Project Commitments. At the project level (individual zone site) of commitment, private sector organizations are often best equipped to assemble the inputs required to create a marketable product. Specific zones are increasingly the responsibility of private developers throughout all stages of project development -- including planning, financing, and management of the project.

Although private sector zones are best suited for zone development and management, public sector organizations can also support specific free zone projects by the following means:

- site assembly assistance, including possible transfer of improved or unimproved government properties to a private free zone development group;

- upgrading of infrastructure/services, including enhanced port or airport cargo handling facilities, special access to satellite communication links, and/or improved road and rail connections to the free zone; and

- coordination of national educational and technical training programs with specific free zone needs.

The combination of a powerful national free zone program with specific zone initiatives (operated on a businesslike basis) gives the sponsoring country a highly marketable "product" in the global competition to attract investment and stimulate exports.

II. PROGRAM ELEMENTS (PUBLIC SECTOR COMMITMENTS)

Given the intensity of regional and global competition, Latin American and Caribbean countries today must create export sector regimes that remove obstacles to business expansion in a comprehensive rather than fragmentary way. Half-way measures to establish Export Processing Zone regimes, in particular, are unlikely to be competitive given the alternatives increasingly found in neighboring countries. By virtue of the limited geographic size of free zones, Governments often find it possible to introduce sweeping policy liberalization measures (and/or reforms in public institutional arrangements) that would be fiercely resisted by vested interests if implemented over a national scale.

The following measures may be particularly useful for Latin American/Caribbean free zone programs seeking to establish international reputations for competitiveness:

A. Eligibility Criteria for Free Zone Incentives

As noted in the overview section above, predictability (or "transparency') in qualifying for incentives is the most important factor in maximizing the economic stimulus of a free zone program. The legacy of import substitution has left many countries in Latin America and the Caribbean with restrictive national policies for entry by new firms, especially for prospective startups with 100 percent foreign ownership. Foreign investors encounter case-by-case treatment of their application by criteria which are often vague and leave room for differing interpretations. A typical venture -- whether local or foreign owned -- also is frequently required to submit applications to multiple state or parastatal organizations to obtain rights to do business. In consequence, delays of six months to two years have been reported on the part of investors seeking authorization to begin operations in many instances. Continuing such a system in a free zone incentives program tends deter many prospective investors from considering establishment of business operations in a zone.

An EPZ program in free zone-sponsoring countries can introduce a radical change in the transparency of the system. At its ultimate, countries can adopt a Singapore or Hong Kong-style investment registration system, in which a prospective free zone user can complete the paperwork to register the company and obtain legal status to begin operations in a single morning or afteroon. (The simplicity of obtaining approvals to begin operations, coupled with their minimal tax, tariff, and regulatory operating constraints, has given Singapore and Hong Kong an invaluable business reputation.) The operative assumption toward investors is "innocent unless proven otherwise" -- a reassuring message to private firms. Under a registration system, however, all investors should be put on notice that their operating rights are forefeit in the event of fraudulent or misrepresentative statements regarding their background and operations, or in the event of failure to abide by the public health and safety laws of the country, or in the case of other breaches of law or contract. The presence of a vigorous public sector "spot check" capability acts as a deterrent to undesirable firms that otherwise might seek to do business in free zone-sponsoring countries.

Alternatively, if an investment registration system is considered too ambitious, the principle of predictability (if not immediacy) can be introduced in an investor application process. EPZ programs in the Dominican Republic and Costa Rica, and the related duty-free "maquila" system of Mexico, have achieved high levels of automaticity over the past decade, even though the formal authorization of investment meeting clearly defined criteria may take two to four months. For countries desiring to adopt a competitive investor application process, these criteria should be neutral regarding the size of the export operation, and the extent of local or foreign ownership. The investment approval criteria also should not discriminate between zone-based enterprises that are engaged directly in the export of goods and services, and zone-based companies providing support services to zone-based industries. Finally, the process should stipulate automatic approval of the investor application within a defined period, unless action to the contrary were taken by Government to disapprove the project.

The sponsoring Government can underscore the overriding transparency and open access of a free zone program by adopting a stand-alone statute (backed by specific implementation regulations). This legislative document does not necessarily need to be integrated with the existing or proposed investment code; indeed, it can and should serve as an distinctive magnet for new export-oriented investors.

B. Substance of the Incentives Program

In creating a world-class enabling act, the following substantive provisions deserve consideration by the governments of free zone-sponsoring countries:

1. Full exemption from Customs duties. High Customs duties at present deter many potential export-oriented investors who would otherwise consider establishing operations in Latin American and Caribbean countries. A cornerstone of successful free zone legislation consists of removing all import taxes and other levies on imported capital equipment, as well as on all imports of raw materials, intermediate goods, and supplies used in free zone manufacturing. For a free zone to be internationally competitive, Customs duties must be completely exonerated for companies engaged directly in export, for zone-based firms serving the needs of other zone tenants, and for the zone developer.

2. Relief from corporate taxes and governmental/parastatal levies and fees. Comprehensive relief from taxes and other charges is another essential element in a competitive free zone incentives package. At present, the effective rate of taxation on businesses in some Latin American countries exceeds 60 percent of income. To compound the problem, complexities in the tax code often add a substantial paperwork burden to the corporations seeking to do business.

   An optimal free zone incentive act should provide for generous and across-the-board tax relief, including complete corporate tax holidays for a defined period or very low flat tax rates in perpetuity. Normally, free zones provide complete tax exemptions (except for payroll tax contributions) for periods of ten years or more; Jamaica, Honduras, and Uruguay provide total tax relief in perpetuity. Some countries have chosen to adopt a low flat rate of tax rather than a corporate tax holiday. In Mauritius, measures introduced in 1984 reduced the corporate tax rate on non-free zone firms from 65 to 35 percent; and in 1985/86 the free zone act was changed, imposing a nominal corporate tax rate of 15 percent on free zone firms over the whole life of the firm and increasing the exemption of income tax on dividends to 10 years. This, however, was done only after a successful free zone program had been developed (which took fifteen years from the establishment of the initial act).

   Another crucial element consists of limiting the power of future governments to impose taxes under another name upon free zone users. Uruguay's recently enacted free zone law does the most compelling job of safeguarding zone users against "backdoor" taxes, by discouraging port charges and other fees or "encumbrances" from being imposed upon zone occupants by governments and/or parastatals except as clearly and directly needed to finance benefits for the zone users. In these cases, the authorities are obliged to demonstrate that they are pricing the charge at direct cost recovery levels.

3. Unrestricted foreign currency holdings and remittance of invested capital, dividends, fees, and profits. At present, regulations governing ownership, exchange, and movement of foreign exchange are cumbersome and complicated in many developing countries of the Caribbean and Latin America. To resolve this critical problem for export businesses, free zone incentives typically allow zone-based companies to establish hard currency accounts as an aid to doing business, to freely exchange currencies and engage in transactions with currencies of their choosing (except when purchasing local factor inputs, in which case hard currencies must be converted through the Central Bank to local currencies), and to move capital, dividends, and other payments into or out of the zone without specific public sector approval.

4. Liberalization of labor market controls. Without affecting crucial safeguards for worker health and safety or rights of collective bargaining, some countries have found EPZS to be useful in liberalizing labor codes. The People's Republic of China was among the first to do so in the late 1970s as part of its campaign to attract investors. More recently, several African countries have used free zone incentive regimes to ameliorate the powers of Government over compensation levels for the various job skill categories, and to provide for more freedom on the part of employers in hiring and firing workers. In Trinidad and Peru, free zone proponents have supported similar approaches to amend existing labor codes that require companies to undergo costly, time-consuming procedures when forced to lay off staff. Such liberalization creates a greater balance between the interests of management and labor, providing both with the flexibility to be competitive and prosper in the international marketplace.

   Free zone enabling acts can also liberalize controls governing the status of foreign personnel. Within limits (between 5 to 20 percent of the workforce), some free zone-sponsoring governments have made hiring and travel approval procedures almost automatic for technical and managerial personnel of free zone industries, albeit with stringent penalties for misrepresentation by free zone firms of the background of the individuals or their functions. Countries such as The Bahamas, by contrast, have steadily moved in the other direction, applying severe restrictions regarding employment of expatriate staff. Procedures to obtain permits to employ expatriates tend to be difficult and lengthy, and the economic vitality of Freeport, Grand Bahamas, has suffered accordingly.

5. Permission for private sector organizations to finance, develop, and operate free zone supporting infrastructure such as telecommunications and power supply. Business-like zone development and management organizations are best able to assure foreign investors of a relatively problem-free business operating environment. Declining costs of telecommunications and power supply, moreover, have enabled zone development organizations in an increasing number of cases to privately finance needed infrastructure improvements for their tenants at world market prices. Accordingly, countries such as Costa Rica, the Dominican Republic, and Uruguay have taken the lead in encouraging private sector roles in financing and management of zone development and infrastructure. In some cases, the infrastructure (or even the zone itself) is financed and operated by foreign investors for a defined period and subsequently transferred to local private or public partners under a "Build-Operate-Transfer" (BOT) agreement.

6. Relief from other public sector-imposed constraints, including price controls, performance requirements, etc. The governments of many developing countries at present have a large number of price controls, margin controls, and other forms of regulatory constraints that limit export sector development. In some cases, as in Uruguay, free zone incentives have explicitly removed such constraints.

C. Administration of the Program

A proper legislative/regulatory framework is a necessary, but not sufficient, condition for success of an EPZ program. For the zone project to achieve its intended results of attracting substantial export industries, the host country must consider improving the capabilities of public sector institutions to foster and oversee the free zone regime.

Free zone-sponsoring governments in many Latin American and Caribbean countries, accordingly, should consider undertaking the following institutional development initiatives:

1. Investment Review/Oversight Institution

The institutional function of investment review and monitoring can be quite simple in practice. As noted above, the optimal free zone regime, from the standpoint of stimulating investor interest in the country, provides for an investment registration rather than an application process. Under this approach, free zone-sponsoring countries establish a single unit at which foreign (and domestic) investors register their free zone company, and are authorized immediately to begin business operations within the zone. The investor thus has essentially automatic and immediate entitlement to free zone incentives, provided that general qualifying criteria (e.g. nonhazardous and noncriminal inputs, processes, and products) are met. Hong Kong, Singapore, and the United States are among the leading practitioners of investment registration systems.

Under an investment registration framework, the responsible public sector institution has the right to rescind right a free zone company's access to incentives if the zone user steps afoul of clearly established groundrules. Accordingly, institutional capabilities are essential to investigate the backgrounds and activities of the registered companies. The presence of an active and effective public sector monitoring capability acts as a deterrent to shady or abusive investors.

A more complicated (but more common) alternative to an investment registration system is an institutional process that conducts a detail investment application review of each company *prior* to indicating its approval. Although widely used by EPZs world-wide, this approach has a severe disadvantage of increasing the delay and uncertainty of legitimate investors. Because free zone users are often small enterprises with no experience in the host country, they may discount an unfamiliar public sector process that holds inherent delays. Businessmen want to know "where they stand" with a country in order to take full advantage of sudden plant expansion needs or shifting markets. Some loss of interest in free zones is thus inevitable as a country moves away from an essentially automatic and immediate registration process.

Adverse effects of this approach have been minimized in practice by some free zone-sponsoring countries, through creation of a "one-stop-shop" in which foreign firms are able to complete investor application procedures in a matter of weeks or days, if not hours. The responsibilities and functions of such a center include consolidating all of the associated permits necessary for doing business in one physical location, enabling the applicant to procure water, power, sanitation, and health, and labor-related forms without delay for priority processing. In Costa Rica, a physical center -- housing multiple ministries -- has been created in lieu of consolidating all approval powers within a single administrative body. Investors seeking application approvals reportedly can thereby obtain them in 45 minutes or less.

Normally, responsibilities for overseeing the free zone program are vested in an institution such as the Ministry of Industry or the Ministry of Finance. Such an institution may or may not be assigned the responsibilities for investor registration and/or application review. The focus of its responsibilities is to ensure that the companies operating under EPZ status (including the zone developers and managers themselves) are abiding by the framework established in the free zone legislation. Toward this end, it should establish implementing regulations and monitor compliance with the groundrules established in the zone program, including the following:

- Review and evaluation of applications by developers and user industries to invest in free zones;
- Preparation and periodic updating of procedures, rules and regulations to be followed in implementing the free zone Law;
- Monitoring performance and growth of free zones and publishing findings periodically, including all relevant statistical data such as land area developed, buildings completed, buildings occupied, jobs created, gross and net foreign exchange earnings; and
- Analysis and recommendation of changes in national policy and development strategies affecting the free zone program.

The primary role of the review and oversight agency should be to review and approve or disapprove free zone developer and user behavior, within clear groundrules established by the free zone regime. It should not become a free zone development agency.

2. Customs

Numerous problems are reported throughout Latin America and the Caribbean in expeditiously clearing goods through Customs. To be successfully marketed internationally, an EPZ regime must offer timely and efficient customs procedures. The Dominican Republic and Costa Rica have taken strong measures to achieve efficient Customs clearance procedures, by guaranteeing immediate clearance of goods under seal to the zone for opening on-site (under Customs supervision) and by establishing an audit-inspection system. Increasingly, countries have found it effective to create a special unit within the Customs Service with responsibility for overseeing the free zone regime. As a means of incentivizing the Customs Service as a whole to work towards a successful free zone program, consideration should be given to introducing performance-linked budgeting. Several African countries are devising formulas to link the annual funding for zone-based Customs staffs to the amount of space leased by zone assembly and manufacturing industries that they administer.

C. Central Bank

A special "window" at the Central Bank, or at Central Bank-designated commercial banks, can be useful in allowing zone firms to hold and freely control foreign exchange accounts in developing countries. Unrestricted access to foreign exchange at world market prices can be essential for the success of free zone firms. As with the Customs Services in the case of imported and exported goods, the paperwork procedures of the banks for transfering and converting funds should be kept simple, automatic, and immediate. When the procedures are too complex, or the official exchange rates deviate substantially from market rates, EPZ industries tend to rely upon offshore intermediaries to "transfer price" out their profits.

III. PROJECT-SPECIFIC ELEMENTS

Individual free zone projects tend to be implemented most effectively by private sector organizations that have resources "at risk" in zone development. The leading free zones in the Western hemisphere (e.g. San Cristobal and San Isidro in the Dominican Republic, and Cartago, Metropolitana, and Alajuela in Costa Rica) are owned and operated by private investors.These

EPZs have established an excellent overall reputation with tenants for standards of service and responsiveness. Nonetheless, public sector organizations can make essential contributions on behalf of individual free zone projects, sometimes in critical ways.

A. Zone Site Assembly Assistance

A potential fast-track approach to private free zone development is for government or parastatal organizations to transfer to private free zone developers suitable government-owned lands, and/or existing industrial estates that have suffered from poor management. In such cases, the 12-18 month lead time required between the start of a free zone project and the completion of initial factory buildings can be substantially reduced. (In practice, however, public sector organizations often balk at the prospect of transfering landholdings to private EPZ developers, as in the Dominican Republic.) Alternatively, the Central Bank of the sponsoring country might agree to offer an expedited debt to equity conversion on favorable terms to foreign or local private investors seeking to buy or lease a site for free zone development. Costa Rica pioneered the use of debt conversions for private free zone development, and other Caribbean countries have expressed interest in following suit.

B. Off-Site Infrastructure and Services Development

As part of a commitment to improve conditions for free zone development, the governments of developing countries can give priority to offsite infrastructure improvements facilities serving specific zone projects. Transportation bottlenecks deserve particular attention; the rapid growth EPZs in Costa Rica, Jamaica, and the Dominican Republic has strained existing vehicular transportation corridors and led to expenditures to widen roads and improve bus services. Similarly, demands on national port, airport, telecommunications and power infrastructure can grow rapidly. Anticipating and remedying such deficiencies can be critical to the medium- and long-term success of individual zones.

C. Linkages to National Training Organizations

Free zones have been at the forefront of developing linkages between industry needs and national training institutions. Recognizing the critical role that "human capital" plays in investor location decisions, private zone developers in countries such as Costa Rica and the Dominican Republic have sought out national and local training centers to affiliate with, often making space available without charge for such institutions to undertake zone-based training programs In contrast to past approaches in which vocational and technical institutions operated without close coordination with the export sector, such programs often benefit from private/public sector parytnerships in design of curriculums, purchase of up-to-date machinery, and participation of business executives as guest lecturers and advisors.

IV. POTENTIAL EPZ CONGRUENCE/CONFLICT WITH NATIONAL EXPORT SECTOR DEVELOPMENT STRATEGIES

In essence, EPZs represent a striking departure from many past approaches to stimulating export sector development. Past bilateral and multilateral programs have often lent support to development institutions operating on an "enterprise targeting" basis, in which they direct resources to specific enterprises determined to be well suited for sustained growth. EPZs, by contrast, adopt a "business climate" strategy for strengthening the export sector.

The advantage of an "enterprise targeting" approach, from the standpoint of the sponsoring institutions, is the tangible nature of the process and the active participation of these institutions in choosing beneficiaries. Program administrators identify high-potential firms, assess their needs, and direct resources to them. Substantial control throughout the process is retained by the responsible organization or organizations.

Yet limitations exist in the "enterprise-targeting" approach. Prospective applicants normally far outnumber the amount of resources at hand, enabling few such programs to reach more than a handful of their potential beneficiaries. Given the public nature of their resources, program administrators often must create a detailed review process for the applications that they receive, leading to sometimes lengthy periods of uncertainty for applicants before they are notified of results. In the review process, program administrators tend to prefer proven and well credentialled applicants to unproven (higher risk) entrepreneurs, thus reinforcing well-connected businesses rather than opening the field to new entrepreneurs. Three other almost intractable problems are encountered. The first is high "overhead" costs on the part of the program for each client ultimately served, resulting from the magnitude of the screening and review procedures required. The second is the risk of corruption inherent in discretionary aspects of the decisionmaking process. The third, and final constraint, rests with the inherent reluctance of capable entrepreneurs (who often lack paperwork skills and/or trust in government assistance programs) to enter a lengthy application process in which only a small percentage of the applicants will succeed.

EPZs, by contrast, can establish a climate of certainty for virtually all comers. They offer liberal business conditions to all enterprises meeting simple qualifying criteria, regardless of their size, paperwork skills, influential connections, track record, or ownership. EPZs embody, in microcosm, the market-oriented policies that have been a priority focus for AID and other development institutions in their encouragement of macroeconomic reform. By "getting the business climate right" in a designated demonstration area, the benefits of free market economic stimulus can be automatically and immediately realized by local and foreign enterprises alike. And participants in the marketplace, rather than the program administrators, subsequently assume responsibility for determining the success or failure of the firms operating within the zone.

EPZs nonetheless can be considered as enterprises to "target" for assistance in their own right. They are real estate development ventures capable of generating rents (in hard currency) to the degree that an attractive business climate is forthcoming from the sponsoring government. EPZ developers therefore potentially stand at the intersection of "enterprise targeting" initiatives and measures to promote fundamental economic policy reform. To the degree that bilateral and multilateral institutions can induce governments to adopt the necessary programmatic elements for EPZ success, private sector interests should be more than willing to make commensurate project-level commitments.

Effective public sector removal of programmatic obstacles, combined with the project-level commitments by the private sector to develop a specific project, can give a country a "marketable product" -- the basic requisite for export sector success. The experience of the Dominican Republic, Costa Rica, and Jamaica has shown the use that national investment promotion organizations can make of such marketable products. EPZs in these countries have been a central focus of investment and export promotion organizations, as tangible evidence of the sponsoring country's commitment to removing obstacles to business growth. Privately-owned and operated zones are typically among the first stops normally scheduled by national investment promotion organizations in the Dominican Republic and Costa Rica for overseas firms undertaking site selection missions. In these countries, moreover, reciprocal partnerships have emerged between national promotion institutions and individual free zones. The national investment promotion campaigns generate investor leads for EPZs, and the parallel privately-funded promotion campaigns mounted by individual zones reinforce the message being sent by the national promoters to the international business community. Catalytic support for EPZ projects by bilateral and multilateral development institutions, accordingly, can bring highly leveraged returns.

THE DOMINICAN REPUBLIC

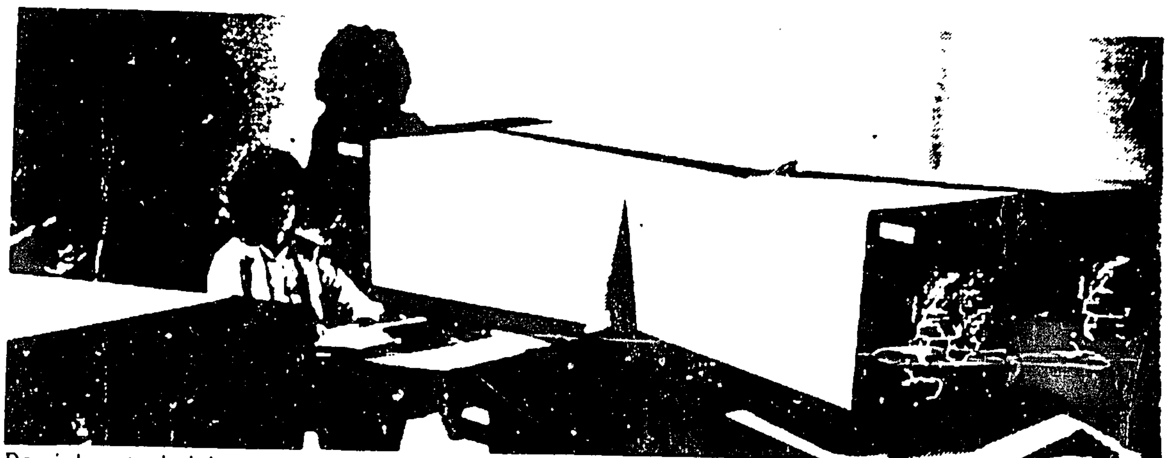
Free Zones Attract Investors

160 Firms Now Employ 52,000 Workers in Manufacturing for Export; Demand for Factory Space Is Strong

THERE IS A WAITING LIST FOR factory space in the Dominican Republic, as developers of free zones strive to keep up with burgeoning demand.

Free zones (zonas francas in Spanish) now house more than 160 firms that employ a total of 52,000 workers, compared with only 29,000 in 1984. The value of free zone exports to the U.S. will grow an estimated 51%, to $309 million, between 1985 and 1987.

Foreign investors like the free zones because they offer a convenient, sheltered environment, free of taxes (for 12 to 20 years) and import duties, with unrestricted repatriation of profits. Also 20% of production may be sold to the substantial local market, providing that the item is not now being manufactured here.



Dominican technicians engaged in computer graphics work at CODETEL.

These benefits have existed for several years, but what triggered a virtual stampede of foreign investors was the devaluation of the Dominican peso in January 1985, to a roughly 3-1 ratio against the U.S. dollar—dropping the minimum wage here to about 50 U.S. cents an hour. This made labor-intensive work here very attractive. Even at higher skill levels, wages are much lower than in the U.S., with experienced mechanics and electricians earning about $311 a month, managers $880 and engineers just under $1,100.

Garment Production

The bulk of the free zone employment is now devoted to garment production. Zone exports to the U.S. of men's cotton suits and slacks, for example, shot up from zero in 1984 to $7.8 million in 1985, and to $44 million last year. But there is also considerable activity in the manufacture of cigars, electrical components, jewelry, leather articles, shoes and fur coats. Small firms are now being joined by an impressive roster of "Fortune 1,000" companies.

And, in the midst of this explosive growth, there has emerged an intriguing new twist: the genesis of a services industry based on electronic data entry. But, we're getting ahead of our story.

There are now seven free zones in operation, five are under construction and more than 20 others are at various stages of planning.

Among the newer free zones (founded in 1985) is the Parque Industrial Itabo, S.A., on 46 acres at San Cristobal, near the major port of Haina. Plans call for 200,000 square meters of manufacturing space.

Itabo President Manuel A. Tavares reports that Westinghouse already has four new plants there, with 500 workers producing electro-mechanical devices, wiring harnesses and printed circuit boards. Space has also been contracted to firms such as Hanes (T-shirts); Baxter-Travenol (medical supplies); GTE (subassemblies for the auto and electronics industries); and Bristol-Meyers (medical products). Mr. Tavares adds that "six other firms, all Fortune 1,000, have already committed, but not yet announced," that they will set up operations at Itabo. He estimates that employment at Itabo will reach 3,000 to 4,000 workers by the end of 1988.

Westinghouse Offshoots

The Westinghouse plants at Itabo are offshoots of the company's operations in nearby Puerto Rico, where it has some 20 manufacturing plants. Higher costs in Puerto Rico (where the U.S. minimum wage is applicable) were making some of its plants there unprofitable, says Ken Wilson, general manager of Westinghouse's operations in the Caribbean and Mexico. Setting up "twin plants" between the Dominican Republic and Puerto Rico, he says, enables Westinghouse to benefit from lower wage levels in the former, and to retain the advantages of Section 936 of the Internal Revenue Code in the latter, allowing repatriation of profits free from federal taxes. Several other major U.S. firms with investments in Puerto Rico have set up Dominican twin plants, and others (such as Bristol-Meyers) are in the process of doing so.

Information services (electronic data entry) is a brand new area of activity in the Dominican Republic, and it appears to hold considerable promise for the future.

CODETEL, the local phone company, (a subsidiary of GTE) now has hundreds of Dominican engineers and draftsmen engaged in computer graphics work, transferring hand-drawn plans and blueprints to a computer format, at a fraction of what it would cost in the U.S.

This future-oriented work is already evident at the new San Isidro free zone, located on 128 acres five miles from the Port of Santo Domingo and 12 miles from Las Americas International Airport.

Industrial-Office Park

"San Isidro offers both an industrial park and an office park specializing in data entry," says José M. Cerón, the free zone director. Within six months, construction (by ITT) is expected to begin on a $3 million earth station that will transmit, via satellite, work generated at San Isidro.

Among the new tenants at San Isidro is American Airlines, whose subsidiary—AMR Caribbean Data Services—already has a data entry operation in Barbados to process the airline's tickets. Mike Montgomery, director of the new venture at San Isidro, says he is enthusiastic about "the huge potential here." Mr. Montgomery looked at several countries before deciding to locate in the Dominican Republic. "What impressed me most was the combination of low labor rates and the vast amount of qualified workers," he says.

The company is actively marketing its service to U.S. firms (such as airlines and insurance companies) that do labor-intensive "data-capture" work. Thus far, 200 "extremely qualified" employees (average salary $100 a month) are at work in a 5,000-square-foot facility. "We're planning a 40,000-square-foot building in anticipation of growth," says Mr. Montgomery, "and I expect we'll have more than 1,000 workers here within a year."—K.W.

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Washington Times, July 7, 1989

Hong Kong industrialists planning exodus

HONG KONG (Agence France-Presse) — Three-fourths of Hong Kong's industrialists are planning to emigrate as confidence in the future of this British colony continues to slide after the turmoil and crackdown on dissent in China, a survey published yesterday shows.

The poll, conducted by the research section of the Federation of Hong Kong Industries, says 75 percent of industrialists plan to emigrate, compared to only 40 percent in the federation's May poll.

The federation predicted a worsening of the territory's "brain drain" and said the flight of capital would accelerate as 1997 nears. That's the year Hong Kong reverts to Chinese sovereignty under a Sino-British pact signed in 1984.

Hong Kong residents have been unsuccessful in attempts in recent weeks to force the British government to grant the 3.25 million Hong Kong citizens holding British travel documents the right to live in Britain.

British Foreign Secretary Sir Geoffrey Howe was faced with huge demonstrations this week.

All 66 survey respondents, from the plastics, toy, electronics, garment and textile industries, agreed that events in China had had a negative impact on Hong Kong and said a drastic drop in confidence in Hong Kong's future would be difficult to reverse.

About 70 percent of the manufacturers in the survey said disruption in transportation and telecommunications in China affected their production there.

Another 30 percent said their Hong Kong operations were affected, with business negotiations suspended and overseas orders put on hold.

With 30 percent of the industrialists saying they intended to review their investments in China and another 30 percent saying they were ready to adopt a similar approach toward their local interests, the federation said future investments here would be restricted to ventures for short-term returns and Hong Kong's desire to develop high-tech industries would be hindered.