A Study of Iranian’s Free Zones Throughput; Success or Failure in Achieving Proposed Goals?

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Abstract: Free Zones have been the tools by which many countries have overcome their economic crises and create new employment and reduce poverty without waiting many years for the whole economy to be reformed. Iran has been reconsidering its economical structures over time. Establishing Free Zones and especial economic zones in 1994 was a specific aspect of this effort. However, after more than ten years, it seems the predefined goals set by government not to be achievable and these zones have not been able to provide expected refinements in Iran's economy. The aim of this study is to look at the function of Iran's zones in employment, domestic and foreign investment absorption, import and export which analyzed by related evaluation parameters. The assessment results showed that absorbing foreign investments by Iranian Free Zones can play a positive significant effect on increasing employment rate in Iran. In spite of this fact, the results showed that Iran's Free Zones were unsuccessful in absorbing foreign investment and appeared as the site of imports instead of exports and in fact have failed to achieve the predefined goals.

Key words: Free industrial and special economic zones, import/export, economy, Iran

INTRODUCTION

A Free Zone is a portion of clearly defined and isolated land, or enclave, with special fiscal and customs status (Facchini and Willmann, 1998; Guangwen, 2003). There are currently more than 20 types of Free Zones in the world, including free ports, export processing zones, commercial free areas, areas of free trade, free depots, customs depots, fiscal depots and off-shore finance centers (Facchini and Willmann, 1998; Guangwen, 2003). New types of Free Zones are also being developed such as tourist, medical, educational and logistical Free Zones (Haywood, 2004). The present boom in e-commerce, b 2 b, also introduces virtual Free Zones (Ryan, 2007). Nowadays, these economical districts have changed to be a powerful new economic tool. ILO (International Labour Organization) (2003) report shows a sharp increase in the number of Free Zones in the world since 1970s till 2000s (Table 1).

Generally speaking, economic zones could be categorized in five major types, each of which differing from others in on or more primary characteristics. These categories and their main properties are shown in Table 2. Regarding regional distributions, statistics show that Free Zones are mostly located in North and Central America and Asia, respectively (International Labour Organization, 2003) (Fig. 1).

### Table 1: The number of world Free Zones in 1970s vs. 2000s

<table>
<thead>
<tr>
<th></th>
<th>1970s</th>
<th>2000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Countries with Free Zones</td>
<td>30</td>
<td>120</td>
</tr>
<tr>
<td>Free Zone projects</td>
<td>80</td>
<td>2000</td>
</tr>
<tr>
<td>Private zones</td>
<td>0</td>
<td>1200</td>
</tr>
<tr>
<td>Total export</td>
<td>$6 billion</td>
<td>$600+ billion</td>
</tr>
<tr>
<td>Direct jobs</td>
<td>1 million</td>
<td>50 million</td>
</tr>
</tbody>
</table>


![Regional distribution of world's Free Zones](image)

Fig. 1: Regional distribution of world’s Free Zones

Meanwhile, locating in an economically competitive region, Iran has already tried to enjoy the vast benefits of free trade zones (Chachian, 2001). In order to expand and

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accelerate the volume of non-oil exports, social economic development of deprived and undeveloped districts of Iran and create new job opportunities, the Iranian government considered the establishment of Free Zones (Dimmore, 2001). The first five year Economic and Social Development Plan was ratified by the Majlis (Parliament) in January 1989. Sub-article 19 of this bill has called for the creation of three Free Zones. These zones were supposed to be created in order to better utilize Iran's production capacity, its prime geographic and strategic maritime position. To achieve this goal, Iran has established 6 Free Zones and 16 Especial Economic Zones. Table 3 shows name, year of establishment, space and the activities field of Iranian Free and Especial Zones.

In order to encourage and support Iranian and foreign investors, Iran's Free Zones has tried to provide numerous economic incentives, including: foreign investment guarantee on capital and earned profit, unlimited free movement of capital and earned profit, possibility of using financial facilities of Iranian offshore bank branches, availability of insurance coverage, free entry and exit for raw materials, semi-finished goods, machinery, etc., possibility of recruitment of foreign experts in investments plans, no need for entry visa for foreigners, possibility of Free Zone partnership in some investment projects, the possibility of unlimited investment for both Iranian and foreign nations, 100% ownership of buildings and other facilities for foreigners, 15 years of tax exemption on personal income and assets, freedom to import any products with the exception of those prohibited by Islamic laws of Iran, importation of goods with a minimum of protocols, simplified procedures
RESULTS

The results showed the amount of foreign investment in three Iranian Free Zones (Kish, Qeshm and Chahbahar) is nearly 15 times less than domestic investment (2099 to 30576 million dollars) during the course of this study, 1996 to 2004 (Fig. 2). The proportion of import to export is nearly following the same pattern, 10.5 times more import comparing to the amount of export from those three Iranian Free Zones (Fig. 3) while at the same time, natural and industrial products of the mentioned Free Zones estimated up to 621 million dollars.

When different rates were calculated the rate of foreign investment to employment was 0.008, the ratio of foreign investment to domestic investment appeared to be 0.068, the rate of export to import came up as 0.094 and the rate of export to domestic industrial

![Fig. 2: The amount of foreign investment in three Iranian Free Zones (Kish, Qeshm and Chahbahar) comparing to domestic investment in million dollars](image)

![Fig. 3: The amount of import in three Iranian Free Zones (Kish, Qeshm and Chahbahar) comparing to the amount of export in million dollars](image)
production was 0.068. At the same time the rate of export to domestic industrial production computed as 0.393 (Table 4).

### DISCUSSION

Iran contains 1% of the world population and 20% of world gross product. In the 4th country development plan (from 2005 to 2009), it has anticipated the country to achieve 40% of annually average gross growth by absorbing foreign investment. It has been assumed that Free Zones can act as the major channel for absorbing foreign investment. The results of this study demonstrated that while one of major goals of Iran in establishing Free Zones was absorbing foreign investment, Free Zones did not meet this goal. To analyze this result, we consider the position of Iran in global foreign investment by two important economical indexes: foreign investment absorption index and foreign investment absorption potential index. Later on, we consider the reasons of which foreign investments do not come to Iran.

The foreign investment absorption index is defined as the portion of a country in global investment to the portion of that country in global production (UNCTA, UN., 2006). The countries which their index is equal to one have absorbed the foreign investment in harmony with their economical potential. The countries with foreign investment absorption index higher than one have behaved smartly and absorbed foreign investment greater than expectance. In the period of 1990-1998, this index for Iran was equal to 1, while in the period of 1998-2000, this index decreased to 0.

Foreign investment absorption potential index which varies between 0 to 1 has defined based on variables like domestic growth production rate, the portion of export in domestic growth production, commercial use of energy, the portion of research and development to the net domestic production and economical and political risk in a country (UNCTA, U.N., 2006). Based on statistics, this index for the period of 1980 to 1990 was equal to 0.154 which has been increased to 0.278 in the period of 1998 to 2000. This shows that the position of Iran for absorption of foreign investment has been improved.

United Nations Conference on Trade and Development (UNCTAD) in the report of 2006 has considered the foreign investment in different countries based on the two above mentioned indexes; the foreign investment absorption index and the foreign investment absorption potential. UNCTAD has divided countries to 4 groups; (1) strong performance and potential, (2) strong performance and weak potential, (3) weak performance and strong potential and (4) weak performance and weak potential (Table 5).

Iran has been categorized in countries which have high potential in absorbing foreign investment, but functioned weakly in this area. As a result and with respect to calculated evaluation parameters in this study, It can be concluded that although Iranian planners tried that by establishing Free Zones and offering legal economic incentives provide the suitable environment for absorbing foreign investment, Free Zones were unsuccessful in achieving this major goal (Dinmore, 2001).

One of the critical reason which keeps foreign investment away from Iran is the high risk of investment. The report of Economical Information Unit declares that in 2006, like 2005, Iran has located in the rank 38 among 60 studied countries in the view of investment risk. Conversely, according to this report, Singapore has appeared as the safest country for investment. In the Middle East, Emirates with the rank of 11 was the first lowest risk country for foreign investment. So it is expectable that even with higher investment potential of Iran, foreign investments move to Dubai, especially Emirates. It should be noticed that foreign investment guarantee on capital and earned profit in Iran is one of the governmental legal incentives for lowering investment risk. However, it seems that decreasing investment risk in Iran needs to more political and economical factors like increasing economic power, economic security, stabilization in foreign relationships, enhancement of economic infrastructures, improvement of banking and currency regulations, reducing investment formalization, granting tax exemption, budget allocations and creation of proper infrastructures.

High rate of unemployment is one of the major problems of Iran’s economics. As mentioned before, the ratio of foreign investment to employment in Iran’s Free Zones (0.008) shows that absorbing foreign investments by Iran’s Free Zones can play a major role in decreasing unemployment rate. However, on the other hand, high risk
of investment prevents flowing foreign investments to Iran. Since the rate of foreign investment to employment in the studied period (1994-2004) is lower than 1:4 (0.008), it can be inferred that absorbing foreign investments has positively significant effect on increasing employment rate. As a result, government and economical planners can access to the high employment rate by providing the suitable environment for absorbing foreign investments. In consistent with our results, it has been argued that the formation of Free Zones may work as the second-best policy in increasing national welfare and decreasing unemployment (Young and Miyagiwa, 1987). But it should be emphasized again that the rate of foreign investment to domestic investment during the course of this study was just 0.068 in Iranian Free Zones which is clearly very low and as a result, Iranian’s Free Zones did not behave well in the absorption of foreign investment.

In the case of the ratio of export to import, the ratio was again very low, just 0.094. This clearly shows that these regions acted as the place of import rather than the platform for export. Since, one of the major aims of establishing Iranian’s Free Zones was to expand non-oil exports; this finding shows that these regions also were unsuccessful in achieving this goal. As a result, the relative effectiveness of these regions in expanding export in Iranian developing country can be in doubt. Moreover, the rate of export to domestic industrial product was 0.393 which is far from one. This one also shows that up to now, the productions of these regions had no essential characteristics for competitions in global markets and confirms ineffectiveness of Iranian’s Free Zones in producing competitive industrial products. So, it seems that none of goals were considered in setting up Iranian Free Zones have been achieved so far and major revision in their operation should be implemented as soon as possible.

ACKNOWLEDGMENTS

We would like to greatly thank the Azad University for supporting this study and the Secretary of Presidency High Council of Trade/Industrial Free Zones for providing data and support.

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