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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 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 positively 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

	1970s	2000s
Countries with Free Zones	30	120+
Free Zone projects	80	2000+
Private zones	0	1200+
Total export	\$6 billion	\$600+ billion
Direct jobs	1 million	50 million

Source: International Labour Organization (2003)

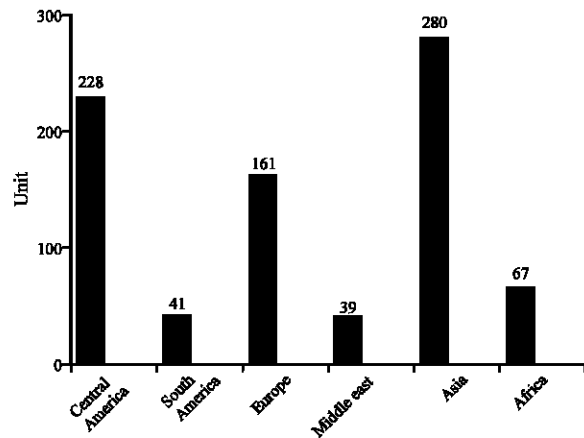


Fig. 1: Regional distribution of world's Free Zones

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

Table 2: Major categories of economic zones and their characteristics

Economic zones	Objective	Typical size	Location	Eligible activities	Markets
Industrial zone	Industrial development	Less than 100 ha	Mixed	Industry	Domestic, Export
Free trade zone	Support trade	Less than 50 ha	Ports, Airports	Mostly trade-related processing and services	Re-export, Domestic
EPZ	Export manufacturing	Less than 200 ha	Ports, Airports	Mostly manufacturing	Export
Enterprise zone	Urban area renewal	Less than 50 ha	Inner city areas	All	N/A
SEZ/FEZ/Freeport	Integrated development	Less than 100 km ²	Mixed	Multi-use	Domestic, Internal, Export

Table 3: Iranian Free Zones and Especial Economic Zones

Free Zone 's	Year of establishment	Space (km ²)	Activities
Kish	1993	90 km ²	Tourism industries, hotels and motels, shopping malls, trading centers, offshore Banking
Chabahar	1993	140 km ²	Increasing Iran's share in international transit and exterior to produce and export industrial and processed goods.
Qeshm	1993	300 km ²	All types of industries, unloading, transit and transshipment of goods to the area as well as to middle Asia.
Aras	2004	80000 ha	Industrialists and exporters.
Arvand	2004	165 km ²	Attracting investment oil and petrochemical and agricultural conversion industries, transit
Anzali	2004	3200 ha	Export, transit, tourist attractions,
Especial Economic Zone			
Pars Energy	1998	10000 ha	Energy, Oil and gas, petrochemical industries
Sarakhs	1995	5200 ha	Stands as a connection between central Asia, the open seas and Persian gulf southern countries
Mines and Metals	1997	1200 ha	Mines and metals
Yazd	2000	570 ha	Textile
Busheher	2000	Two region 375 ha	Proper facilities for loading and loading shipping industries, export service-providing center.
Sirjan			Advanced transportation networks, maintenance and storage of goods.
Shiraz	2000	3000 ha	Electronics and information technology
Persian Gulf Ship Building	2001	110 ha	Building vessels, repairing vessels, marine offshore structure, export-oriented services.
Salafchegan	1997	2000 ha	Export, re-export, transit, warehousing, packing industries
Arg-e-Jadid	1997	1000 ha	Investment in industrial and commercial activities notably car making sector
Petrochemical	1997	2000 ha	Encourage development of petrochemical production and trade, both at regional, national and trans national levels, especially in downstream industries, transfer of modern technology into the country and export of petrochemicals.
Amirabad Port	1997	60 ha	Transit goods transit oil commodities and commercial goods, roll-on roll-off dock for the train sandtrucks.
Shahid Rajei	1997	20 km ²	Port, transit, train's shipment, re-export.
Payam	2001	3600 ha	Freezing services, depot operation, packaging and export of Persian bells
Lorestan	1999	71 ha	Stones, processing of various kinds of ornamental and building stores.

Source: Secretary of Presidency High Council of Trade/Industrial Free Zone's. Iran. Legal economic incentives, provided by government, in Iranian's Free and Especial Economic Zones

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 (Dinmore, 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, Iranian'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 off-shore 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

for the exportation of goods, simplified and suitable work procedures with minimal administrative formalities, possibility of setting up a production line and sell a portion of productions to the Iranian market, banking system based on international regulations and possibility of foreign investment up to 100% in establishment of banks and insurance companies (High Council of Trade/Industrial Free Zones S.O.P., 2006). Taking into account these incentives, which are really unusual regarding to the mainland regulations, it is necessary to assess the efficiency and throughput of Iranian's Free Zones, so this study was conducted to fulfill this goal by measuring different variables.

MATERIALS AND METHODS

To evaluate Iranian's Free Zones efficiency in this study, four variables including the rate of foreign investment to employment, the rate of foreign investment to domestic investment, the rate of export to import and the rate of export to industrial domestic products were measured in these regions. The rate of foreign investment to employment clarifies that in comparison with the international standard, for establishing a job how much foreign investment has been done. Whatever, this ratio is lower; the foreign investment is more efficient. Based on international standards, when this ratio is lower than 14 to 1, investment is acceptable. The rate of foreign investment to domestic investment shows whether these regions were successful in absorbing foreign investment or not. If this ratio is bigger than one, the region is successful in absorbing foreign investment. The rate of export to import clarifies that a Free Zone has acted as the place of export or import. Whenever, this ratio is higher than one, the region is successful in export and can be assumed as export platform. Conversely, when this ratio is lower than one, the region is unsuccessful in export processing and calls import platform. The rate of export to industrial domestic product demonstrates that how much of domestic products of these regions have exported to international markets? In fact, this rate clarifies whether Free Zone's manufactures have enough characteristics (including high quality) for competition in international markets or not. Whatever this ratio is closer to one; region's manufactures had higher capabilities for export.

In the present study, the data of 3 old Free Zones, including Kish, Qeshm and Chabahar, from the Secretary of Presidency-High Council of Iranian Trade/Industrial Free Zone (the main official organization responsible for managing Iranian's Free Zones) was employed, the above mentioned variables calculated and data presented here.

RESULTS

The results showed the amount of foreign investment in three Iranian Free Zones (Kish, Qeshm and Chahbahr) 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

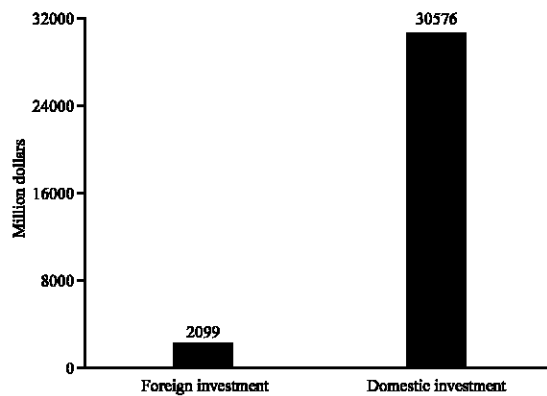


Fig. 2: The amount of foreign investment in three Iranian Free Zones (Kish, Qeshm and Chahbahr) comparing to domestic investment in million dollars

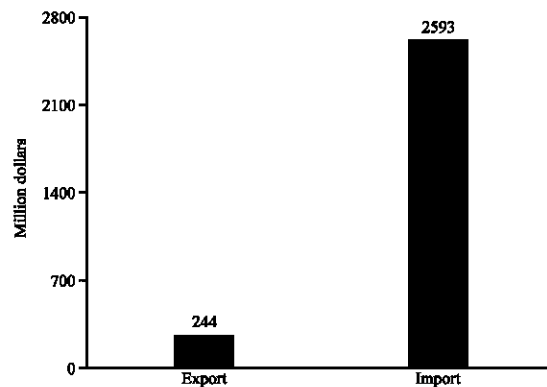


Fig. 3: The amount of import in three Iranian Free Zones (Kish, Qeshm and Chahbahr) comparing to the amount of export in million dollars

Table 4: The results of assessment parameters in three Iranian's Free Zones (Kish, Qeshm and Chabahar) from 1996 to 2004

Assessment parameter	Amount
The rate of export to domestic industrial production	0.393
The rate of export to import	0.094
The rate of foreign investment to domestic investment	0.068
The rate of foreign investment to employment	0.008

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

Table 5: Performance and potential of different countries in absorbing foreign investment

Potential	Weak performance in absorbing foreign investment	Strong performance in absorbing foreign investment
High potential in absorbing foreign investment	Iran, Saudi Arabia, Turkey, Brazil, Russia, China	Germany, France, Malaysia, Singapore, Hong Kong, Bahrain, Emirates
Low potential in absorbing foreign investment	Bangladesh, Nepal, Burkina Faso, Syria, Venezuela	Sudan, Tajikistan, Mongolia, Bolivia, Georgia

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 (Dimmore, 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 58 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 Emirates, especially Dubai. 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 14 (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.

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