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RESEARCH ARTICLE

How Free Trade Zones Help Benefit Businesses and Create Jobs: A Comparative Study of Iran, Turkey and the UAE

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Abstract: The term “free zone” refers to designated areas in which companies are taxed very lightly and it enhances global market presence by attracting new business and foreign investments. For over a century, governments around the world have sought to boost and exploit the economic power of their particular regions and zones by designating them as “special” or “free” economic zones. The trend of establishing such zones or areas have gained momentum in the last four or five decades with countries accounting for small businesses and millions of direct or indirect jobs. The Middle East, especially the countries in the Persian Gulf, for some and other reasons, have particularly embarked on such a trend. The current paper tries to highlight benefits and challenges faced by free trade zones in Iran, Turkey and the United Arab Emirates, taking into account recent global financial crises.

Keywords: Free Trade Zones; Financial Benefits; Middle East; Persian Gulf; Iran; Turkey; UAE.

Introduction

Many countries designate certain areas within their borders as a free trade zones which help not only minimize international trade barriers rather enable importers and exporters to operate under better conditions. However, many importers and exporters are remained unfamiliar with free trade zones as well as uncertain how to take advantage of them.

Free, foreign, and export processing zones fall under the umbrella of being free trade zones and a distinction often depends on their location. Generally, *Foreign Trade Zone* is a term used in the United States of America whereas *Free Trade Zone* or *Export Processing Zone* are the terms used in developed and developing nations. Generally, such a zone is located near ports for convenience. In some cases, however, they are designated elsewhere to accommodate a specific industry or trade.

Using the qualitative method based on library materials, the current paper tries to analyze locations, types of businesses, job benefits as well as challenges faced by these free trade zones in Iran, Turkey and the United Arab Emirates.

Iranian Free Trade Zones

Iran's interest in free zones can be traced back to the 1970s when the potential development of Kish Island in the Persian Gulf was first advocated. After the termination of Iraq-imposed war as well as economic reconstruction of 1980s, the first concrete step was taken to realize this objective particularly under the auspices of the First Five Year Development Plan (Hakimian, 2008). In this first wave, three free zones were announced -- *Kish* and *Qeshm* in the Persian Gulf, and *Chahbahar* (also in the south but on the littoral of Sea of Oman). After about a decade and a half, three more came up: *Aras* and *Anzali* in the north, in the proximity of the Commonwealth of Independent States, and *Arvand* in the south, bordering Iraq and Kuwait (Atlas Gitashenasi).

This initiative was followed up with the setting up of 15 Special Economic Zones (SEZ) throughout Iran. While the free trade zones aimed at attracting Foreign Direct Investment (FDI)

(Graham, 2004) as well as promoting Iran's non-oil exports, the SEZ were conceived for goods transit and improving the supply and distribution networks in the country (Zakeri, 2006).

Given the relatively recent history of many of the Iranian zones, it is probably too early to fully evaluate the performance and impact of these zones. However, available evidences show a mixed picture and a challenging start for many of the zones. For instance, Kish Island – arguably the most successful Iranian zone – is better known for its success in developing as a centre of domestic trade and commerce rather than as an export platform. Attracting FDI and jobs creation on a significant scale no doubt remain the major challenges for all Iranian zones.

Some of these challenges apply at the micro level i.e. design, operation and management of the zones themselves. However, we argue that the macro picture is also critical to their ultimate success. With growing regional competition, Iran's zones can be at a disadvantage if policies pursued there are largely decoupled from, and at odds with, those in the mainland. Streamlining both sets of policies and giving a consistent signal to investors will be critical to enabling Iran to exploit its undoubted strategic potential as a major regional economic powerhouse.

Table 1. Imports and Exports at Iran's Free Trade Zones (in \$ mln)

| Years | Kish | | Qeshm | | Chabahar | | Total | |
|-------|---------|---------|---------|---------|----------|---------|---------|---------|
| | Exports | Imports | Imports | Exports | Imports | Exports | Imports | Exports |
| 2001 | 136.6 | 4.0 | 247.8 | 9.5 | 100.0 | 0.06 | 484.4 | 13.6 |
| 2002 | 135.2 | 3.0 | 445.3 | 11.5 | 102.3 | 0.30 | 682.8 | 14.8 |
| 2003 | 82.0 | 4.0 | 194.5 | 114 | 73.8 | 0.20 | 350.3 | 118.2 |
| 2004 | 68.2 | 6.3 | 162.4 | 40.5 | 105.3 | 0.20 | 335.9 | 47.0 |

Source: Secretariat of the High Council of Free Trade-Industrial Zones (Tehran 2001, 2004)

In 2010, Iran ranked sixth globally in attracting foreign investments. As at 2012, 400 foreign companies are directly investing in Iran. It absorbed US\$24.3 billion of foreign investment from 1993 to 2007 and US\$34.6 billion for 485 projects from 1992 to 2009. Ultimately the positive signs could be beneficial for FTZs and could lead to their increased volume of trades. As a matter of fact,

the Government of Iran said its planned FDI in 2011 was \$4.3 billion and planned FDI will reach \$8-10 billion in 2012-13.

Iran needs up to \$300 billion in foreign direct investment to meet the objectives of its Five-Year Economic Development Plan (2010-2015), and reach eight percent economic growth rate. Turning to "Vision 2025", the plan has set an investment target of \$3.7 trillion within two decades (2005-2025) of which \$1.3 trillion should be in the form of foreign investment.

Turkish Free Trade Zones

Turkey issued Free Zones Law in 1985 with the objective of increasing export-oriented investment and production in the country, accelerating the entry of foreign capital and technology, procuring inputs and increasing the utilization of external finance and trade possibilities. With those purposes, Turkish authorities encouraged all types of industrial and commercial activities through certain tax exemption and incentives

There are more than two dozen FTZs in Turkey (Quarterly Report of the Under-secretariat for Foreign Trade, 2006). The five free trade zones with the largest trade volume are Istanbul Leather and Industry Free Trade Zone, Aegean Free Trade Zone, Istanbul Ataturk Airport Free Trade Zone, Mersin Free Trade Zone, and Istanbul Thrace Free Trade Zone. The Bursa Free Trade Zone is also an important venue in the Marmara Region, and it is the free trade zone with the sixth largest volume of trade in Turkey (www.isbi.com.tr).

With respect to infrastructure and volume of trade, Turkish Free Zones provide a good example in the region. In this context, technical and project assistance have been given to the countries in the region to help establish their free zones. Turkey even signed a joint protocol with Georgia in 1995 to carry out technical and feasibility studies to establish the Georgian Free Zones. Perhaps, this is the reason the Turkish free trade centers have developed over the past few years

enormously. In general, a great variety of activities can be performed in Turkish Free Zones such as manufacturing, storing, packing, general trading, banking and insurance. The turnover of some of the zones is as much as \$ 2 million dollars (www.isbi.com.tr).

However, Turkey has also been exposed to financial problems faced by the United States and Europe following the 2008 global downturn. Perhaps this led Turkey to take steps towards forming the bloc by signing an agreement with its southern neighbors - a move being viewed in some quarters as further evidence that Ankara is losing interest in joining the EU.

But such a deal seems uncertain due to Turkey's direct or indirect involvement in regional conflicts. Ankara's role in the ongoing unrest in Syria and Iraq are considered to be a main challenge to the formation of a regional economic bloc. Critics say that Recep Tayyip Erdogan, Turkish prime minister's plans for closer union with the Muslim world is impossible due to its involvement in regional disputes. Ankara's support to armed opposition groups in Syria has concerned many regional states.

Over the past decade, Turkey adopted a proactive foreign policy agenda in the Middle East with the goal of promoting peace and security. Within the framework of 'zero problems with neighbors' policy, the government took unprecedented steps to normalize its relations with its neighbors. But, the so-called Arab Spring and the seismic shifts that followed in the region have upset this balance.

Table 2. Volume of Trade at 5 Major Turkish Free Zones (US \$ 1.000)

| Years | Istanbul Leather | Aegean | Istanbul Ataturk | Mersin | Istanbul Thrace | Bursa |
|-------|------------------|----------|------------------|-----------|-----------------|-----------|
| 2011 | 3603.223 | 5747.500 | 2,241.525 | 2,693.049 | 1,533.749 | 1,571.579 |
| 2012 | 3220.084 | 5221.937 | 2,103.566 | 3,832.246 | 1,443.596 | 1,532.317 |

Source: Data from Directorate General of Turkish Free Zones, 2012

The ratio of exports from free zones to total Turkish exports stands at 5.13%. A total 19 FTz generate 56000 employments with total trade volume 235billion dollars by 2012, 1.8 percent increase from 2011. Authorities plan to push the export volume to 500 billion dollar by 2023.

There are more than 30 fully functional free zones in the UAE, each with an authoritative body in place, located either near seaports or airports, or as clusters of companies in key locations. The UAE's trade, which was primarily limited to oil and oil based commodities for a long time, was opened up, inviting foreign companies in varied sectors. This strategy has served to open up the economy, while creating a business environment and rules and regulations that have been more conducive to attracting foreign direct investment into the country.

UAE Free Trade Zones

The United Arab Emirates is the leading business hub which offers access to a market of outstanding potential for overseas companies to plan to set up their offshore company. A growing, prosperous, diversified, and accessible and open market are among its key characteristics.

The Free Trade Zones have been set up with the specific purpose of facilitating investment. The procedures for investing in the zones are relatively simple. The companies operating in the Free Zones are treated as being offshore companies or outside the UAE for legal purposes. The free zones are suitable for companies intending to use UAE as a regional manufacturing or distribution base, with the bulk of their business outside the UAE.

Dubai Airport Free Zone, Dubai Auto Zone, Dubai Healthcare City, Dubai International Academic City, Dubai Internet City, Dubai International Financial Centre, Dubai Knowledge Village, Dubai Media City, Dubai Gold and Diamond Park, Dubai Multi Commodities Centre, Dubai Silicon Oasis, Dubai Techno Park Dubai Techno Park, International Media Production Zone, Jebel Ali Free Zone, JLT Free Zone

Jebel Ali, the flagship free zone operations of Economic Zones World has seen continued growth in the number of new companies joining the Free Zone. At the end of Q3 the number of new companies that joined the Free Zone stood at 347 (Fias, 2006). Ras Al Khaimah is another fast-growing and most cost-effective free trade zones in the UAE. Just recently, it organized a special business event that was attended by more than 400 clients of the free trade zone, from

different industries such as trading, consulting, and industrial. The Ajman and Dubai Airport Free zones have also reported impressive growth rate in sales revenues for the first half of 2012.

However, regional and the world scenarios have also impacted the UAE and its trading centers. The global financial problem has not only put glittering Persian Gulf free zones at the stake rather many international investors remain suspicious over the future of these centers.

Table 3. Trade Volume, Import-Export at UAE Free Trade Zones (Dh billion)

| Years | Volume | Imports | Export |
|-------|--------|---------|--------|
| 2009 | 286.6 | 167.9 | 118.7 |
| 2010 | 352.8 | 201.4 | 151.4 |

Source: Khaleej Times

The total trade volume in UAE free zones and markets posted 23 per cent year-on-year growth in 2012. DAFZA alone contributed AED 52 billion to the total volume of Dubai trade in 2010, representing 5.8 per cent of the total volume of trade. RAK FTZ grew by 10 per cent in 2009 in terms of new company registrations, and in 2010 these numbers rose 14.65 per cent over the previous year.

The Rise of Free Zones

The introduction of Free Trade Zones and Special Economic Zones has featured as key components of many developing countries in the last few decades. This trend has been justified in several ways. First, free zones are considered by host countries as magnets for attracting foreign direct investment and an essential plank of the strategy to promote manufactured exports and achieve long-term economic growth. Second, for countries with high unemployment, free zones are seen as spearheads for job creation helping to reduce unemployment both in regional and national contexts (Miyagiwa, 1993; Madani, 1999).

Free zones have a long standing history in the Middle East region going back to the 1960s and 1970s. The majority of these zones, however, act as trading platforms rather than manufacturing

zones hence, this has severely limited their economic contribution. One exception is Dubai, where the government-developed zone such as Jebel Ali has been turned as a major logistics hub (Akinci and Crittle, 2008: 28-29).

The steady rise of the free zones has indeed reflected the developing countries' hopes of reaping lasting economic gains to generate employment, to boost foreign exchange earnings and to induce technology transfer. These hopes have generally fuelled perceptions that establishing FTZs necessarily raises welfare in the host country.

Development of Iranian Free Zones

The interest in setting up and operating trade zones in Iran traced back to the 1970s, but the momentum gathered pace in 1992 with the ratification of laws governing free zones. The economic context in which Iran's experience of FTZs originated deserves some attention. Given the isolationism of the post-revolutionary period as well as the ravages imposed by the war with Iraq during the harsh decade of the 1980s, these zones were clearly seen as attractive to the global economy, whilst the wider question of Iran's position in the international economy itself could be deferred – awaiting the test of the time (Iran, 2010).

The early zones were selected principally for their proximity to Iran's international waters and hence seen as gateways for and potential links to the wider international economy. The customs rules adopted for the zones, too, exacerbated the tendency for them to develop as import platforms for the mainland. These rules allowed domestic travelers to the zones to take back (import) goods with them onshore according to Iran's general customs and excise regulations. This practice had the inadvertent impact of encouraging their development as major centers of domestic tourism and leisure for the burgeoning domestic tourism. Second, Iran's continued isolation limited possibilities for international tourism giving the zones an edge in attracting a growing number of domestic tourists. Thus, in early years the zones became major conduits for imports of consumer goods which sprang up on the back of growing domestic tourism. This practice was however,

contrary to the spirit of setting up FTZs as export platforms and was subsequently abandoned in 2003 when the three new zones mentioned above were set up (Zakeri, 2006: 3-4).

For the Free Trade Zones, in particular, the principal objective was to help reduce Iran's isolation from the international economy by attracting and promoting foreign direct and domestic investment to boost manufacturing exports. This is why they are carefully located in areas with good, strategic links with major waterways and key regional markets for Iran. This is seen as an important mechanism to enable Iran to develop its non-oil exports and to diversify the economy.

There is little doubt that Iran commands much economic and geo-political significance in the Middle East and is of immense interest on the international arena. This contrasts its external perceptions, which may generally depict it as a risky choice for international investment.

Iran boasts a large land mass has a sizeable population and is the fourth largest oil producer in the world. Its natural gas reserves account for 15% of the world's total – placing it second after Russia. It has a good education and health care system with abundant supplies of literate and technically trained personnel. Moreover, its rich culture and history as an ancient civilization offer unique tourist attractions enhancing its potential as an important gateway between East and West.

In this context, Iranian special zones offer a wide range of attractions to draw new businesses and FDI into the designated areas.

Free Zones & Regional Challenges

As we have seen, for over a decade now, regional free zones have sought to act as special havens for attracting capital investment and spearheading quest for economic diversification. Offering economic incentives and facilities the zones in Iran, Turkey and the UAE have aimed to entice domestic and foreign investors to create jobs and to promote exports.

Yet, the experience of free trade zones around the world indicates that the hallmark of success lies in their ability to exploit geographic and strategic advantages with business friendly environments to attract and promote inward investment. The latter in turn requires provision of

economic incentives, a clear legal framework, streamlined bureaucracy and necessary infrastructure.

Two factors, however, hamper an evaluation of the performance and impact of these zones: the relatively recent history of many of them, and paucity of information for others, which do have a longer history.

Challenges facing free zones so far can be broadly attributed to two sets of factors: those emanating from the design and operation of the zones themselves, and those relating to the broader macro picture, namely economic policies and the general business climate, and growing regional competition.

As we have seen, several zones including the Kish Island in Iran, Antalya in Turkey and Dubai in the UAE have been the most successful ones. But, it seems that even these centers have strayed away from their original objectives of export promotion and jobs expansion as it came to emerge into more of a centre for domestic trade and tourism rather than as an export platform. Given that Iran had just emerged from the consumer goods hunger and the higher costs of traveling abroad, the rule gave Kish an edge in its appeal to Iranian travelers keen to exploit commercial opportunities for purchasing foreign goods at competitive prices. This may not be true with Turkish and the UAE zones but still they have their own problems to reckon with. Despite this flexibility, the proliferation of such bodies can be confusing in practice and may indicate lack of a uniform approach to management and governance matters.

It would be wrong to ascribe all of the challenges faced by the zones to their design and operation matters only as the wider macro context in which they are situated in is also critical to their ability to attract inward investment and to their ultimate success. This requires an examination of their relationship with the mainland and an understanding of how competitive international business perceives the business climate more widely.

Unfavorable domestic economic policies and business environment have aggravated by Iran's fraught international relations, which have meant the flow of FDI into Iran has been more of an uphill struggle. Even before the recent nuclear standoff with the West, which has led to targeted

sanctions against Iran's international interests, the US unilateral sanctions have, for over a decade since 1996, deterred foreign investors away from Iran.

With regard to Turkey and the UAE, their constant involvement in regional problems and attempt to get closer to the West has angered many countries. Syria and Iraq are the recent examples which can no longer be part of Turkey's planned regional bloc.

Conclusion

The new developments in the region and the shifts in the geopolitical balance over the last couple of years have posed significant challenges to commercial interests of some countries. The deterioration of relations with Syria, Iraq and Iran has upset the order Turkey succeeded to bring about in its neighborhood, few years ago. In the new evolving landscape, Ankara is also faced with challenges to its energy security and Kurdish militants. The conflict in Syria has also become a source of tension between Ankara and Tehran.

It would be wrong to ascribe all of the challenges faced by the zones to their design and operation matters only as the wider macro context in which they are situated. Despite Iran's undoubtedly promising potential as a major regional economy, its actual ability, or inclination, to attract inward foreign investment has been curtailed by sets of factors in recent years.

Overall, the growing importance of other regional economic powers, with a determination to initiate economic reforms and set up mega economic cities in recent years pose tough competition to Iran, Turkey and the UAE.

Perhaps, Iran and Turkey should not hesitate to negotiate with all relevant actors that could contribute to the solution of the regional problem. This will not only help to minimize their own differences rather help them boost their economic interest in the region and beyond.

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چگونه مناطق تجارت آزاد به نفع کسب و کار و ایجاد اشتغال کمک می‌کنند: مطالعه تطبیقی ایران ترکیه و امارات متحده عربی

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چکیده

اصطلاح منطقه آزاد اشاره به مناطق تعیین شده دارد که در آن شرکت‌ها مالیات بسیار اندک پرداخت می‌کنند و با افزایش جذب سرمایه‌گذاری‌های خارجی و ایجاد کسب و کار جدید به آرامی در بازار جهانی حضور می‌یابند. بیش از یک قرن، دولت‌ها در سراسر جهان به دنبال افزایش و بهره‌برداری از قدرت اقتصادی مناطق خاص خود با تعیین مناطقی به عنوان مناطق اقتصادی ویژه و یا آزاد هستند. روند ایجاد این مناطق یا نواحی در چهار یا پنج دهه گذشته اوج گرفته است و به گونه‌ای که برای میلیون‌ها نفر از کشورهای به‌طور مستقیم و یا غیر مستقیم شغل ایجاد کرده است. به برخی دلایل در خاورمیانه به‌ویژه کشورهای خلیج فارس چنین روندی آغاز شده است. مقاله حاضر تلاش می‌کند که با در نظر گرفتن بحران مالی جهانی مزایا و چالش‌های مناطق آزاد تجاری در ایران، ترکیه و امارات متحده عربی را بررسی کند.

واژه‌های کلیدی: مناطق تجارت آزاد، منافع مالی، خاورمیانه، خلیج فارس، ایران، ترکیه، امارات متحده عربی.

