



Università
Ca' Foscari
Venezia

Master's Degree in
Global Development and
Entrepreneurship

Final Thesis

Free Zones: the global experience through legislation

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Academic Year

2018 / 2019

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INTRODUCTION

The interest in free zones is continuously increasing, despite the processes of tax and customs homogenization advancing rapidly, thanks to the job of the World Trade Organization (WTO).

Over the past thirty years, the phenomenon of free zones has developed rapidly, not only internationally, but also nationally. In 1970 only a few countries were equipped with it, but already in 1996 the Organization for Economic Cooperation and Development (OECD) estimated that there were about 500 industrial export free zones located in 73 countries, while the international list drawn up in 1997 from the World Economic Processing Zones Association (WEPZA) indicated in well 830 the total number of export free zones and commercial free zones spread all over the world. Most of these areas are located in developing countries and are mainly concentrated in three geographical macro-areas: south-eastern Asia, Central America and southern Mediterranean¹.

The free zones are still becoming an increasingly important economic reality and are growing exorbitantly in terms of number.

Indeed, these tools are an attraction for investors and for companies that want to be more competitive in world trade.

Moreover, they are valid means of making a country's economy grow both in terms of revenue and in terms of jobs. More precisely, the creation of an attractive and well-functioning free zone also concerns the infrastructures and services that it can offer. Therefore, jobs will be created both for the construction of the area and for the companies that will operate, which will most likely benefit from the labour of the country in which they are going to establish.

Regarding the activities that can be carried out within the free zone, it is good to specify that any industrial and commercial activity can be carried out, as well as any type of service provision, based on the type of area. Furthermore, by virtue of the fact that the free zone is considered outside the customs territory of the European Union, transformation and processing activities can be managed without any impact on national indirect taxation.

For these reasons, the free zones can offer numerous advantages to the territories in which they are located, especially to the most disadvantaged territories, just as they can

¹ IANNONE F., *Le zone franche per il libero scambio*, ItaliaMondo - Logistica & Intermodalità, n. 88, 2006 p. 30

guarantee users who benefit from them a series of advantages of competitiveness and simplified taxation, attracting huge quantities of capital and orders, especially from abroad.

Given these premises, in this final thesis I wanted to discuss a topic that I immediately thought was very special and interesting, which I learned about thanks to some courses attended in this master's degree.

This thesis, therefore, is an in-depth study of this economic reality called “free zone” or “special economic zone”, looking at the main countries that also include the main economic powers of the world.

In more detail, in the first chapter I wanted to deal with the topic of free zones in general describing what they are and how they are usually classified. Later, I wanted to briefly recount the origins and history after focusing on international regulation that is still not as developed today.

After a general introduction I wanted to dedicate the following chapters to specify the topic.

Indeed, in the second chapter, I wanted to treat the European Union by deepening the places where is possible to find the zones, the legislation and the issue of state aid linked to unfair competition.

Subsequently, I focused on the Italian situation in the third chapter, taking as examples the port of Trieste and the free zone of Venice.

The fourth chapter debates on free zones in the world. I wanted to consider the United States, Central and South America and Asia. As for the last two, after a brief introduction I chose some countries as examples and analysed their legislation more deeply.

Finally, in the last chapter I wanted to make a comparison between the different legislations and I wanted to analyse which factors affect the success or failure of these areas.

CHAPTER I

1.1 Definition and classification of free zones

In the last 30 years the terminology used to describe what has traditionally been called a “Free Zone” has evolved in a significant way. Therefore, it is not easy to give a universal definition and classification of free zone because every country employs different types of zones and they modify them as needed, but it is possible to find similarities among these.

Different authors and organizations have given their own definition:

- «A Free Trade Zone (Free Port) is a neutral, stockade area where a shipper can put down his load, catch his breath, and decide what to do next»¹;
- «A Free Zone is an international territory which is not subject to the jurisdiction of the territorial state with regard to the circumstances of goods and services, customs treatment, labour law and economical laws, and which can be deemed as an autonomous legal system disciplined primarily by international trade custom and usage²»;
- «Export Processing Zones are fenced-in industrial estates specialising in manufacturing for export and offering their resident firms free-trade conditions and a liberal regulatory environment»³;
- «Export Processing Zones are industrial zones with special incentives set up to attract foreign investors, in which imported materials undergo some degree of processing before being exported again»⁴.

According to the Revised Kyoto Convention of the World Customs Organization, free zone means «a part of the territory of a Contracting Party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs territory»⁵.

This Convention is one of the most important trade facilitation Customs treaties that were developed by the World Customs Organization. It entered in force on 3rd February

¹ TRAMPUS F., Challenges, Threats and new opportunities for the world's Free Zones, *Trasporti. Diritto, economia, politica* n. 89, 2003, p.61

² TRAMPUS F., Challenges, Threats and new opportunities for the world's Free Zones, *Trasporti. Diritto, economia, politica* n. 89, 2003, p.61

³ WORLD BANK, *Export Processing Zones, Policy and Research Series Paper*, The World Bank: Washington D.C., 1992, p.7

⁴ INTERNATIONAL LABOUR ORGANIZATION, *Trade Union Manual on Export Processing Zones*, 2014, p.1

⁵ Revised Kyoto Convention, Specific Annex D, Chapter 2: Free Zones

2006. It is a revision of the International Convention on the Simplification and Harmonization of Customs Procedures, better known as Kyoto Convention, which was adopted in 1973. The revised agreement aims at facilitating trade by harmonizing and simplifying customs procedure and practices by providing standards and recommended practices. Currently there are 114 contracting parties⁶.

More in general a free zone is a geographical or administratively restricted area in which manufacturing activities take advantage from a particular regime in the field of customs and revenues⁷.

It is a part of a country's territory that benefits from particular advantages and customs exemptions. In these areas companies can carry out unrestricted activities of industry, commerce, trade and construction, and regular flows of goods and services is allowed to the rest of the world⁸.

The legal status of the free zone can be established either by the State that exercises the sovereignty over it or by agreements between that State and a foreign one.

The free zone may actually be located outside the limits of the customs area of the State or within those limits. Examples of free zone located within the customs limits are ports and bonded warehouses.

The free zone is characterised by the partial or total exemption of the payment of customs duties or other tax burdens. Therefore it is continuously expanding, also in a rapid way, because it tends to facilitate the territories whose position is geographically or politically less favoured. Moreover, even if free zones operate as offshore locations, they are oriented to the international activity. To avoid unfair competition, preferential duties on sales to the rest of the host economy and other discriminatory practices should be resisted⁹.

In the areas located outside the customs limits of the State the transformation and consumption of the introduced goods are permitted. This advantage, not foreseen in the other free zones, favours the transforming industries, which make use of raw materials and subsidiary products, which are thus exempt from duty. The products of these industries, if re-exported, remain duty free; this tax must instead be paid on products

⁶ World Customs Organization website, www.wcoomd.org

⁷ IANNONE F., *Le zone franche per il libero scambio*, ItaliaMondo - Logistica & Intermodalità, n. 88, 2006 p. 28

⁸ THE MENEREN CORPORATION, *Introduction to International Free Zones*, 2005, p.3

⁹ OECD, *Free zones: Benefits and costs*, OECD Observer, No. 275, 2009, p.19

that are introduced in the territory of the State. National or nationalized goods that arrive in the free zone are considered, for all fiscal purposes, as exported goods.

The most common free zones incentives are therefore:

- Non-discriminatory access to the zone, freedom of transit, and free use of loading and discharging port facilities;
- Simplification of customs procedures;
- Relief from customs duties such as import duties and taxes;
- Fiscal incentives such as relief from VAT, income tax, etc.;
- Financial incentives such as free flow of capitals;
- Subsidised infrastructure;
- Liberalization of transports to and from the area;
- Labour law deregulation¹⁰.

Free zone is not just a custom term, but it can also be referred to a juridical regime characterised by special rules authorized by a State regarding not only goods, but also commercial or industrial activities and operations¹¹.

Therefore it is possible to classify these areas in two main groups:

- Classic Free Zones: these areas are characterised by the exemption of customs duties and sometimes of indirect taxes in order to foster international trade. Among these there are commercial free zones (free trade zones), export processing zones, and free ports;
- Exceptional Free Zone: these areas are characterised by other kinds of tax relieves regarding direct and local taxes, financial and administrative advantages for businesses and incentives of an economic and social nature. Among these there are special economic zones that are experiencing rapid development from the point of view of institutional arrangements, and enterprise zones¹².

Free-trade zones, also called foreign-trade zones, are one of the most important kinds of free zones. In these areas goods may be landed, handled, manufactured, transhipped or re-exported without the mediation of the customs authorities. Only when the goods are moved to consumers within the country in which the zone is located they become

¹⁰ TRAMPUS F., *Challenges, Threats and new opportunities for the world's Free Zones*, Trasporti. Diritto, economia, politica n. 89, 2003, p.64

¹¹ Bankpedia, Associazione Nazionale Enciclopedia della Banca e della Borsa

¹² BUCCICO C., *Il fondamento giuridico delle zone franche urbane e l'equivoco con le zone franche di diritto doganale*, Diritto e pratica tributaria, 2008, p.108

subject to the prevailing customs duties. On the other hand, the items that are imported and then exported remain free from customs duties. Free-trade zones are settled around the most important seaports, international airports and national frontiers-areas where companies are able to obtain many geographic advantages as regards trade.

The fundamental mission of a free-trade zone is to remove from seaports, airports, or borders those obstacles to trade that are caused by high tariffs and intricate customs regulations. For example, one of the advantages is the quicker turnaround of ships and planes thanks to the reduction of formalities of customs examinations and also the ability to produce, refinish, and store goods without restraints¹³. Dubai-Jebel Ali (United Arab Emirates), Colon Free Zone (Panama) and Miami (USA) are some examples of this type of free zone.

Export processing zones are production free zones, usually industrial estates, set up in countries with a great level of underdevelopment as regards the labour market and environmental standards in order to promote industrial and commercial exports. According to the World Bank the EPZ offers special incentives and facilities for manufacturing and related activities. Generally it takes two forms: the traditional EPZ and the hybrid EPZ. The former is characterised by the fact that the entire area within the zone is exclusively for export-oriented companies licensed under an EPZ regime, while the latter is typically divided into a general zone open to all industries regardless of export orientation and a separate EPZ area reserved for export-oriented companies¹⁴. The greatest number of EPZs can be found in the USA, Mexico, China, Philippines and Indonesia.

Free ports comprise a wider area and accommodate a wide range of activities, including tourism and retail sales, they permit people to reside on site, and provide a larger set of incentives and benefits¹⁵. These zones are specifically linked to seaports and airports.

Free ports were created to loosen governmental restrictions so that goods can move freely.

They allow import and export of goods free of duty and sometimes taxes, and provide enterprises with financial, tax, investment and regulatory incentives. Banking, trade barriers, and employment rules are facilitated within the borders of the free port¹⁶.

¹³ *Free-trade zone*, Encyclopædia Britannica

¹⁴ AKINCI G. et al, *Special Economic Zones: performance, lessons learned, and implications for zone development*, The World Bank: Washington D.C., 2008, p.10

¹⁵ AKINCI G. et al, *Special Economic Zones: performance, lessons learned, and implications for zone development*, The World Bank: Washington D.C., 2008, p.10

Examples are Hong Kong, Singapore, Trieste, Hamburg, Bahamas Freeport and Macao. Special economic zones aim at improving the competitiveness of the established companies, the attraction of direct investments, above all from foreign individuals, the increase of the exports, the creation of new jobs and the more general strengthening of the productive system, through incentives to the industrial growth and innovation. Shenzhen, Tianjin and Hainan are the fundamental examples of special economic zones. The enterprise zone is a geographical area, such as a neighbourhood in a city, where a government authority grants special taxes or regulatory exemptions in order to promote local economic development. Enterprise zones are often established in low-income areas or places that are recovering from disasters, such as floods or hurricanes. Enterprise zones are intended to revitalize distressed urban or rural areas through the provision of tax incentives and financial grants. Reduced taxes or regulations, and in some cases special financing, encourage businesses to open the area and hire local residents¹⁷. Examples are Indonesia and Senegal.

Table 1: Types of zones

Type of zone	Development objective	Dimension (hectares)	Typical location	Typical activities	Market
Free Trade Zone	Support trade	<50	Ports of entry	Import, export, transshipment	Domestic, re-export
Traditional EPZ	Export manufacturing	<100	None	Manufacturing	Mostly export
Hybrid EPZ	Export manufacturing	<100	None	Manufacturing	Export and domestic market
Freeport	Integrated development	>100 km ²	Seaports and airports	Multi-use	Domestic, internal and export markets
Enterprise Zone	Urban revitalization	<50	Distressed urban or rural areas	Multi-use	Domestic

Source: "Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development". Research working paper no. WPS 45869, 2008, The World Bank: Washington D.C.

¹⁶ THE MENEREN CORPORATION, *Introduction to International Free Zones*, 2005, p.4

¹⁷ *Enterprise Zone definition*, Investopedia.com

1.2 The FZs in the International Law

There is not any international legal discipline of free zones in the world because states are free to establish zones and grant them with infrastructure, customs, fiscal and financial advantages as needed.

There is a lack of international law and conventions on free zones, but actually international uniformity of regulation is necessary in order to keep up with international competition and to draw a best practice to structuring zones. Policies of national governments are of course very important, but regulation at international level is essential for the creation of free zones because they are connected to the global political economy through trade liberalization and foreign direct investment that are necessary for their existence.

The few existing regulation is formal and is explicitly reported in hard-law forms by international economic organizations. There are also other aspects of regulation that are informal and result from intergovernmental relations or structural relations¹⁸ that is what is called soft-law.

The international hard and soft norms established by these organizations help to establish the conditions for the functioning of the zones as they focus on economic development through integration into the global economy. The norms have three purposes that are to constrain, to facilitate, and to legitimize these areas.

Soft law concerning the establishment of free trade zones are employed to constrain government policy with respect to the level of deregulation. For example, international organizations became concerned about the degree of competition between free trade zones in different countries because multinationals tend to move from one zone to another with more attractive incentives very easily. This led to the fear that competition between zones could be harmful to both zones and governments in the long run and such competition would probably create greater costs for host governments in terms of expenses and forgone revenues than the benefits they would receive from foreign investment. Therefore their aim is to standardize incentives and harmonize national policy in order to eliminate most of the harmful competition through their recommendations and guidelines.

¹⁸ EMADI-COFFIN B., *'Chapter 6: International and global regulation and free trade zones', Rethinking International Organisation: Deregulation and Global Governance*, Routledge, 2002, p.119

Free zones regulations and functioning are supervised by international organisms such as the International Labour Organization (ILO), the World Trade Organization (WTO), the United Nations Industrial Development Organization (UNIDO) and the United Nations Conference on Trade and Development (UNCTAD) that are also the promoters of the establishment of these zones. In addition they try to harmonize national legislation and provide technical assistance to governments. They not only develop soft-law guidelines, recommendations, or norms for the establishment but also provide more specific advice on zone establishment and management, made-to-measure to the needs of the individual government or zone¹⁹.

The main international conventions affecting the regulation and functioning of free zones worldwide are the “Revised Kyoto Convention on the Simplification and Harmonisation of Customs Procedures” and the “WTO Agreement on Subsidies and Countervailing Measures”.

The former contains the definition of “free zone”²⁰ and states that goods introduced in the zone are considered as being outside the Customs territory. It provides also provisions on the functioning of free zone referring to the establishment, the control, the admission of goods, the operations and the security.

The latter provides detailed provisions on export subsidies, countervailing measures and authorised remedies. This Agreement gives the definition of “subsidy” and disciplines only the subsidies related to goods and not those related to services²¹.

1.3 Origins and history

The free zone concept is very old and it is associated to those populations devoted to maritime navigation and free trade such as the Phoenicians, the Carthaginians and the Egyptians. The Greeks brought the free port tool to level of development that is comparable to that of modern times. The Romans too appreciate the free port as an instrument of stimulating commerce. It is equally said, however, that it originated in the ports (e.g. Venice) of the city-states along the eastern and southern coasts of the Mediterranean in the early Middle Age, when the region was experiencing a commercial

¹⁹ An example of the specialized assistance provided by UNIDO was a report prepared by the Weil Public Relations agency outlining the primary characteristics of a free trade zone marketing program to promote the zone concept in the prospective of foreign investors.

²⁰ See paragraph 1.1

²¹ TRAMPUS F., *Challenges, threats and new opportunities for the world's Free Zones*, *Trasporti. Diritto, economia, politica* n. 89, 2003, p.69

revival. The Italian coastal city of Genoa is commonly accepted as the world's first free port, set up in 1547. In this period the free port concept was preserved and developed as a "free town".

The development of the earliest free ports on the east-west sea route of the Mediterranean happened together with another route, colonized by the Hanseatic merchants, in the North and Baltic seas. The new port cities of the north included cities such as Hamburg, Bruges, Copenhagen, and Konigsberg. Those cities were politically independent and controlled largely by a class of professional merchants.

During their overseas expansion from the early 18th to the 19th century, free warehouses, free ports and free towns were created all over Europe, in Russia and in the Colonies as for example Gibraltar, Singapore, Hong Kong, and Djibouti²².

The oldest and best-known form of free zones is the trade-based free economic zone.

Free ports and free trade zones started in America just after the First World War. In 1934, the United States Congress passed "The Foreign Trade Zone Act", permitting the creation of such zones in different parts of the country. In 1936, the first free trade zone was established in New York. These areas concentrated limited commercial activities such as transshipment, storage, packaging and re-export²³.

After the Second World War the establishment of commercially-based free ports and free trade zones gradually left space also for the creation of manufacturing-oriented zones, particularly in developing countries trying to attract foreign capital and to promote exports.

Until the 1950s, most free economic zones in the world belonged to this type of zone. In order to achieve direct and some indirect economic benefits, a trade-based free trade zone is located in a geographically delineated area, usually with, in, or near a seaport, airport, and the hub of communications, but separated from the surrounding national territory by fences or other barriers, where free trade and free economic policy are permitted with the rest of the world, and the trade, storage, processing, and manufacturing in the special case are its dominant economic activities²⁴.

²² CHEN X., *The Evolution of Free Economic Zones and the Recent Development of Cross National Growth Zones*, International Journal of Urban and Regional Research, 2009, p.600

²³ GUANGWEN M., *The Theory and Practice of Free Economic Zones: A Case Study of Tianjin, People's Republic of China*, 2003, p.28

²⁴ GUANGWEN M., *The Theory and Practice of Free Economic Zones: A Case Study of Tianjin, People's Republic of China*, 2003, p.26

Between the late 1950s and the mid-1960s, the first group of free economic zones combining trade and manufacturing functions emerged.

In 1959, Ireland built an export processing zones, the world's first zone to bear such a name, at Shannon International Airport to convert imported commodities into exportable products²⁵. The airport and its free zone have become a focus of activity for industry and services designed to serve primarily the European market.

The second half of the 1960s and the entire 1970s was a golden period for the spread of export processing zones and they continued to rise also during the 1980s.

This type of zone represents a notable functional evolution from the traditional free trade zone, with a predominant orientation toward export manufacturing.

At the same time another kind of zone developed: the service-based free economic zone. In this area a special economic, administrative policy, and deregulation is applied, which is not granted elsewhere in the country, and special economic activities such as finance, insurance, tourism, and other specific services are in operation, in order to maintain the historic competitive edge or to promote the development of remote regions, and, furthermore, achieve economic benefits,

According to the zonal economic activities, the zone can be classified into free banking zones (such as Bahrain, Panama, Luxembourg, Cayman Islands, and the Bahamas), free insurance zones (such as New York and London), free tourism zone (such as Macao, Monaco, Amsterdam, Hamburg, and Nevada).

Unlike trade-based zones, the service based zone is not geographically rigidly delineated or separated from the surrounding host country's territory by fences or other barriers. The zone cannot be only located in regional economic centers such as a big city, but also in economically backward regions with a pleasant landscape and favourable communications, in coastal regions, or in the interior of a country. The zone enjoys not only special policy such as tax reduction and holiday, but also economic and administrative privileges for their special service trade, which the other regions and other sectors cannot enjoy.

Since the 1980s, the free economic zone has evolved further from the manufacturing-oriented export processing zone into the more comprehensive special economic zone, which is exemplified by Shenzhen on China's southern coast.

²⁵ CHEN X., *The Evolution of Free Economic Zones and the Recent Development of Cross National Growth Zones*, International Journal of Urban and Regional Research, 2009, p.600

Special economic zones differ generally from export processing zones as they are more diversified and balanced among economic sectors and covers larger areas. Some special economic zones, however, have unique objectives defined by the country and region in which they are located.

The free economic zone then has evolved in turn in a tool with more advanced functional and spatial characteristics. The first science-based industrial park, that is the Silicon Valley in California, grew out of the Stanford Industrial Park in the late 1950s. The objectives of these zones are more extensive and include: introducing high and new technologies in cutting-edge industries; training highly skilled scientific personnel; and producing close linkages between basic research and practical application through alliances between research universities and high-tech industries²⁶.

In order to promote high-tech industrialization and commercialization and to realize scientific, technological, and economic rapid development, some zones are selected in the city centre or urban outskirts with more research institutes and universities, a suitable living environment, and convenient communications. In these zones preferential policy and privilege are given as they are a network where knowledge, technology, qualified personnel, and capital are highly concentrated.

This historical account shows that the evolution of the free zones is characterized by functional and spatial differentiation and specialization.

The functional and spatial differentiation and specialization of the FEZ through diffusion and transfer would not occur without the effective governance structure and regulation of FEZs facilitating their adaptive and flexible objectives.

In the latest 20 years free zones have become a rapidly developing global phenomenon which affects an increasing share of international trade flows and employs a growing number of people²⁷.

1.4 Free trade zones as an opportunity for economic development

Free trade zones are considered as an opportunity for the economic development of a country as it is a tool to attract national and foreign direct investments. The entire domestic economy benefits from these zones because they are based on the fact that the

²⁶ CHEN X., *The Evolution of Free Economic Zones and the Recent Development of Cross National Growth Zones*, International Journal of Urban and Regional Research, 2009, p.602

²⁷ CHEN X., *The Evolution of Free Economic Zones and the Recent Development of Cross-National Growth Zones*, International Journal of Urban and Regional Research, 2009, p.602

localized deregulation helps to improve the international competitiveness of the investments²⁸. In addition the activities carried out in these areas are generally part of international production and distribution chains of multinationals.

At a global level, the most worked products in free zones concern the textile, clothing, footwear, toys and electronics sectors, which can be produced for mass markets using relatively low skilled labour and high added value activities.

Recently, however, there are also phenomena of localization in free areas of activities based on the use of more skilled labour, for example in the high-tech, finance and tourism sectors. Furthermore, more and more often in free zones there are not only large multinationals, but also small and medium-sized enterprises that act as sub-suppliers for these big companies²⁹.

Free zones exercise a strong attraction of investments in infrastructures and logistic services, stimulating, under certain conditions, the growth of the territories hosting them in terms of added value, employment, exports and technology transfer³⁰.

Governments create free zones because they want to generate economic growth and to integrate the regional economy with the global economy.

Indeed they unify the region with the global economy by creating goods for export, attracting foreign currency, and providing opportunities for companies outside the free zone to trade with international firms.

Moreover they are used for this purpose because the capital, technology and resources that are introduced into the zone create new job opportunities for local workers and business opportunities for local companies to sell goods to companies within the zone.

Free zones are developed to take advantage of a country's comparative advantage in natural resources, existing infrastructure, or labour. A lot of free zones are developed around existing infrastructure to reduce the amount of investment required, to support the facilities already in place and to promote continuing infrastructure development.

Free zones of all types are tools used by governments to create areas of concentrated commercial, trade, or industrial activity. Free zones rely on access to transportation to

²⁸ EMADI-COFFIN B., 'Chapter 6: International and global regulation and free trade zones', *Rethinking International Organisation: Deregulation and Global Governance*, 2002, p.136

²⁹ IANNONE F., *Le zone franche per il libero scambio*, ItaliaMondo - Logistica & Intermodalità, n. 88, 2006, p.28

³⁰ IANNONE F., *Le zone franche per il libero scambio*, ItaliaMondo - Logistica & Intermodalità, n. 88, 2006, p.28

make them feasible. For most free zones, access to one or more modes of transport is critically necessary for the successful development of the free zone.

FZs offer three main advantages relative to the domestic investment environment: they offer a special customs environment including efficient customs administration and usually access to imported inputs free of tariffs and duties; they have historically offered a range of fiscal incentives including corporate tax holiday and reductions, along with an improved administrative environment; and they provide infrastructure (including land, factory shells, and utilities) that are more accessible and reliable than would normally be available outside the zones³¹.

Finally, a free zone can serve as a region where a country with an economy in transition can liberalize the economy without having to make dramatic changes in laws also in the rest of the country³². The concept of free economic zone (FEZ) is a useful policy tool for countries wishing to develop an export-oriented manufacturing sector, but do not have administrative and technical capacity required to develop a national system to allow exporters duty-free import of equipment and materials³³.

Summing up FZs are able to create a better business environment in a geographically limited area, through a more liberal legal and regulatory framework, efficient public services, and better infrastructure within the zone, including better roads, power, water, and wastewater treatment³⁴.

Among the multiple objectives that normally can be assigned to the policies made to create these zones there are: job creation, growth in exports and foreign exchange earnings, facilitating economic diversification, often as a step in processes of industrialization and industrial upgrading, and access to foreign manufacturing technology and knowhow³⁵.

³¹ WORLD BANK GROUP, *Trade issues brief: Special Economic Zones*, The World Bank: Washington D.C., 2010, p.2

³² THE MENEREN CORPORATION, *Introduction to International Free Zones*, 2005, p.6

³³ MAN A., *Correlation of free zones, taxation and economic development*, Journal of Economics and Business Research, No. 2, 2009, p.80

³⁴ ZENG D.Z., *Global Experiences with Special Economic Zones: Focus on China and Africa*, The World Bank: Washington D.C., 2015, p.6

³⁵ WORLD BANK GROUP, *Trade issues brief: Special Economic Zones*, The World Bank: Washington D.C., 2010, p.1

CHAPTER II

2.1 Free trade zones in the EU

Since the second post-war period a process of harmonization and simplification of customs rules has been undertaken by the EU, initially with the aim of reducing the protectionist measures envisaged by the individual States, which in fact constituted an obstacle to the development of international trade; then, to standardize and rationalize customs regimes and procedures, so as to favour a smooth and regular development of international trade; finally, to apply the most modern information technologies in customs relations, to ensure faster and more efficient performance of controls and the "real time" exchange of data and information between operators and customs administrations.

Customs activity in EU countries has undergone a strongly accelerated change since 1993. First of all, the tax activity, that is tax assessment and collection, has been reduced, both due to the progressive expansion of the community territory through the accession of new countries, and to the progressive reduction of duties on imports of goods from third countries with respect to the EU, as a result of the liberalization of world trade.

Currently, the European Union has exclusive competence to legislate in matters of common commercial policy and customs union; therefore also the substantial regulation of the assumptions and methods of application of customs duties falls within the exclusive competence of the European Union.

In this regard, art. no. 28 of the Treaty establishing the European Community states that «the Union includes a customs union that extends to all trade in goods and involves:

- the prohibition, between Member States, of import and export customs duties and of any charge having equivalent effect, as well as
- the adoption of a common customs tariff in their relations with third countries».

The customs union, therefore, is an agreement according to which some States undertake to suppress each customs barrier and to adopt, with regard to third countries, a common customs tariff which guarantees a uniform level of treatment for all imported products, regardless of the point of entry of goods into the territory of the Union itself.

The harmonization of customs regulations without doubt includes also the legislation of free zones in order to create uniform rules necessary to attract foreign investment, produce jobs and boost trade flows with other countries that are needed to foster the

economy of the union in an era of strong competition due to the liberalization of world trade.

Free Zones within the EU have a fixed perimeter with entry and exit points that are subject to customs supervision. The European Union classifies these areas in two categories which depend on how Community and non-Community goods are treated during import and export:

- *Control type I Free Zones:* these areas work like free warehouses, but in this case the Free Zone is not a building but a geographical location. This means that the zone is an enclosed area, physically protected by a fence or wall. All goods placed within the area automatically fall under the Free Zone regime and are checked by the customs authorities;
- *Control type II Free Zones:* these areas are managed in a similar way to customs warehouses. Like the previous type, they deal with geographical areas but the potential physical control does not take place at entry and exit points, but on the basis of stock-taking by the companies present in the area. This means that goods only become subject to the different incentives provided in the Free Zone when they are declared¹. Recently, with the entry of the new Customs Code type II free zones and free warehouses have been cancelled. Type II free zones and free warehouses existing as of 1st May 2016 must be processed by 1st May 2019 in customs warehouses².

In the EU there are at least 91 Free Zone that are already in operation³. The most important are placed in Shannon (Ireland), Madeira (Portugal), Katowice (Poland) and Latvia.

The Shannon duty-free Processing Zone was established in 1959 by the Irish government to support the nearby Shannon International Airport⁴. It was created also with the intent of attracting companies from foreign countries and at creating new

¹ DE JONG, W., *Establishing Free Zones for regional development*, Library of the European Parliament, 2013, p.2

² FABIO M., *Manuale di diritto e pratica doganale*, IPSOA, 2016, p.649

³ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.12

⁴ DE JONG, W., *Establishing Free Zones for regional development*, Library of the European Parliament, 2013, p.3

employment⁵. Today, it is managed by an agency for regional development called Shannon Development.

In addition to the customs agreements that allow companies to defer the payment of taxes on imported goods, the Special Zone provides additional incentives compared to the ordinary tax regime in force in Ireland such as exemptions on VAT on imports, also in relation to raw materials and semi-finished products if the 75% of the final product is intended for exports⁶⁷. Furthermore companies operating in the zone can benefit from a 12.5% corporate tax rate since 2005.

In order to benefit from the established tax incentives companies must obtain a license according to the Irish Customs Free Airport (Amendment) Act. In this Act individuals can find some of the requirements and criteria to be met, such as the creation of new employment and export orientation⁸.

The Madeira International Business Centre was designed as free zone in the 1980s as a free trade zone to boost growth in this poor region, and also for its key position for trade between Portugal and the African coasts⁹. Companies can benefit from significant advantages in custom duties in addition to exemptions and tax reliefs regarding income taxes. Raw material and semi-finished products imported in the zone are free from import duties when they are placed in the EU market if they are to be converted in loco in new products, as they are considered European since the beginning¹⁰. Companies that want to benefit from this incentives must satisfy some requirements such as the creation of one to five jobs during the first half year and a minimum investment of €75 000 in assets during the first two years of activity¹¹.

Poland¹² has 14 Special Economic Zones¹³ that were set up with the Act on Special Economic Zones of 20th October 1994¹⁴ to accelerate growth in those regions through

⁵ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.12

⁶ DE JONG, W., *Establishing Free Zones for regional development*, Library of the European Parliament, 2013, p.3

⁷ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.12

⁸ DE JONG, W., *Establishing Free Zones for regional development*, Library of the European Parliament, 2013, p.4

⁹ DE JONG, W., *Establishing Free Zones for regional development*, Library of the European Parliament, 2013, p.4

¹⁰ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.12

¹¹ DE JONG, W., *Establishing Free Zones for regional development*, Library of the European Parliament, 2013, p.5

¹² It is the country with the biggest number of Free Zones in the EU

different types of tax reliefs and incentives for new companies¹⁵. In 1996 the Polish government established the Katowice Special Economic Zone which comprises 35 different sites in four subzones. Conditions for companies in order to benefit from tax reliefs are a minimum investment of €100 000 with a minimum term of 5 years, and the maintenance of created jobs for at least 5 years. Benefits comprise a significant reduction in income taxes in addition to the possibility of obtaining lots of land at advantageous prices, tax reliefs on real estate, incentives for employment and simplified procedures¹⁶. In addition to these tax incentives, the Katowice Development Corporation provides further services such as the mediation on the real estate market, one-stop shops for investor support, human resources training and office and storage space rental¹⁷. Poland is the country that has the most important tax measure for ZES in the EU. Its corporate income tax can fluctuate between 25% and 55%¹⁸ according to a wide range of variables¹⁹.

Table 1: Examples of Free Zones

	Shannon Free Zone	Madeira Free Trade Zone	Katowice Special Economic Zone
Country	Ireland	Portugal	Poland
Year of establishment	1959	1980s	1996
Number of companies	> 100	≈2900	> 200
Main tax incentives	12,5% Corporate income tax, VAT exemption	Maximum 5% Corporate income tax, maximum VAT of 22%	Tax relief up to 55% of investment costs and labour costs of first 2 operational years
Type of zone	Type II	Type I	Type I

Source: De Jong, W., "Establishing Free Zones for regional development", Library of the European Parliament

¹³ IL SOLE 24 ORE, *Zes*, Argomenti, 2017

¹⁴ This Act was amended in 2008 to comply with EU state aid rules

¹⁵ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.13

¹⁶ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.13

¹⁷ DE JONG, W., *Establishing Free Zones for regional development*, Library of the European Parliament, 2013, p.5

¹⁸ SENATO DELLA REPUBBLICA, *Disegno di Legge: Nuove misure per le zone economiche speciali (ZES) ed estensione delle agevolazioni fiscali alle zone logistiche semplificate (ZLS)*, n.732, XVIII Legislatura , 1st August 2018, p.2

¹⁹ *Special economic zones (SEZ)*, Eurofound website, www.eurofound.europa.eu

It is worth mentioning also Latvia, where there are two Free Zones (Special Economic Zones) and two Free Ports. In all of them, firms benefit from a privileged fiscal regime with incentives such as 80% reduction in property taxes, 80% reduction on the withholding tax for dividends, 80% discount on corporate income tax, and VAT exemption for most of the goods and services supplied to companies in free zones or exported outside of them²⁰.

2.2 Legislation of Free Zones in the EU law

At European level, the subject was initially regulated by the Directive 75/69/EEC. According to article no. 1, now abrogated, the expression free zone means «any territorial enclave established by the competent authorities of member in order that goods therein may be considered as being outside the customs territory of the community for purposes of applying customs duties, agricultural levies, quantitative restrictions or any charges or measures having equivalent effect»²¹.

Successively, with article no. 4 of the Regulation EEC n. 88/2504²² the definition of free zone was changed but actually the meaning remained. It was defined as «part of the customs territory of the Community, separate from the rest of that territory, in which non-Community goods placed in it are considered, for purposes of the application of import duties and commercial policy import measures, as not being within the customs territory of the Community provided they are not released for free circulation or entered under another customs procedure»²³. In this Regulation appears also the notion of “free warehouse” as «premises situated within the Community's customs territory, in which non-Community goods placed in them are considered, for purposes of the application of import duties and commercial policy import measures, as not being within the customs territory of the Community provided they are not released for free circulation or entered under another customs procedure»²⁴.

At the moment for the definition of Free Zone we have to refer to the Regulation (EU) no. 952/2013 of the European Parliament and of the Council of 9th October 2013 laying

²⁰ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.14

²¹ Article no. 1, Council Directive 69/75/EEC of 4th March 1969 on the harmonisation of provisions laid down by law, regulation or administrative action relating to free zones

²² Now abrogated

²³ Art. 4, Council Regulation (EEC) No 2504/88 of 25th July 1988 on free zones and free warehouses

²⁴ Art. 4, Council Regulation (EEC) No 2504/88 of 25th July 1988 on free zones and free warehouses

down the Union Customs Code. This Regulation deals with the legal framework of the functioning of free zone from article no. 243 to article no. 249.

These articles came into force from the 1st June 2016. Earlier, companies had to take as a reference the Regulation EEC 2913/92 and its modifications. This Regulation established the Community Customs Code²⁵.

The article no. 166 sets forth «free zones and free warehouses shall be parts of the customs territory of the Community or premises situated in that territory and separated from the rest of it in which:

- a) Community goods are considered, for the purpose of import duties and commercial policy import measures, as not being on Community customs territory, provided they are not freed for circulation, placed under another customs' procedure, either used or consumed under different conditions than those provided for in customs regulations;
- b) Community goods for which such provision is made under Community legislation governing specific fields qualify, by virtue of being placed in a free zone or free warehouse, for measures normally attaching to the export of goods»²⁶.

According to the article no. 167 Member States may decide which parts of the customs' Community territory become a free zone or may authorize the creation of free warehouses. Free zones shall be enclosed²⁷ and the Member States shall define the points of entry and exit of each zone which are under the supervision of the customs authorities.

The last subsection of article no. 167 and no. 168 better clarify the role of the customs authority: approval for the construction of any building in a free zone and possibility to check goods entering, leaving or remaining in a free zone or warehouse. To allow the custom authority to carry out the inspection of the goods, a copy of the transport document²⁸ and, of course, the goods, shall be made available to the authority by any person entitled for this purpose by such authority.

After the general section, the Regulation contains a set of articles regarding the placement of goods in free zones or free warehouses.

²⁵ BUCCICO C., *Il fondamento giuridico delle zone franche urbane e l'equivoco con le zone franche di diritto doganale*, Diritto e pratica tributaria, 2008, p.107

²⁶ Art. 166, Council Regulation (EEC) No 2913/92 of 12th October 1992 establishing the Community Customs Code

²⁷ Member States are allowed to decide the geographical limits of each zone

²⁸ This document shall accompany goods entering or leaving

The article no. 170 points out that «goods entering into the free zone don't necessarily need to be presented to the customs authorities, nor need a customs declaration to be registered».

In subsection no. 2 stands out the exceptions to the previous subsection: «goods shall be presented to the customs authorities and be subject to formalities only when:

- a) They have been placed under a customs procedure which is released when they enter a free zone or free warehouse; however, where the customs procedure in question allows exemption from the obligation to present goods, such presentation shall not be required;
- b) They have been placed in a free zone or free warehouse due to a decision to grant repayment or remission of import duties,
- c) Goods benefit from the measures referred to in article 166(b)».

The section C of the Regulation deals with the operation of free zones and free warehouses.

According to the article no. 172 «any industrial, commercial or service activity shall, under the conditions of the Regulation, be authorized in a free zone or free warehouse. The carrying on of such activities shall be notified in advance to the customs authorities. Moreover, the customs authorities may impose certain prohibitions or restrictions on the activities referred to in paragraph 1, having regard to the nature of the goods concerned or the requirements of customs supervision».

Article no. 173 states that «non-Community goods that are placed in a free zone may, while they remain in it:

- a) Be released for free circulation under the conditions stated by that procedure and by the article no. 178;
- b) Undergo the usual forms of handling intended to preserve them, improve their appearance or marketable quality or prepare them for distribution or resale without authorization as specified in the article no. 109(1);
- c) Be placed under the inward processing procedure under the conditions stated by that procedure».

If this article is not applied, goods shall not be consumed or used in the free zone. However, paragraph 1 of the article no. 175 shall not preclude the use or consumption of goods, the release for free circulation or temporary imports of which would not entail

application of import duties. In that event, no declaration of release for free circulation or temporary importation shall be required.

The EU legislation deals also with the removal of goods from free zones or free warehouses.

The article no. 177 is the fundamental one which states that without prejudice to special provisions adopted under customs legislation governing specific fields, goods leaving a free zone or free warehouse may be:

- exported or re-exported from the customs territory of the Community, or
- brought into another part of the customs territory of the Community.

The Regulation establishes also formal, customs, and tax reliefs according to the different types of commercial flows:

- Third countries – Free Zone – Third countries (transit);
- Third countries – Free Zone – European Union (import);
- European Union – Free Zone – Third countries (export)²⁹.

Transit is the most beneficial commercial flow. Indeed, goods in transit are not subject to:

- a) Customs duties and formalities;
- b) VAT³⁰;
- c) Guarantees;
- d) Time limits for re-export³¹.

As far as the import hypothesis is concerned, only “suspensive”³² reliefs are included:

- a) The imported goods are subject to import duties when they exit from the free zone;
- b) VAT at destination;
- c) Fulfilment of customs formalities when goods are released for free circulation³³.

Finally, for the export hypothesis, the goods are expected to be subject to:

- a) Export duties;

²⁹ IANNONE F., *Le zone franche per il libero scambio*, ItaliaMondo - Logistica & Intermodalità, n. 88, 2006, p.29

³⁰ Article no. 156, Council Directive 2006/112/EC of 28th November 2006 on the common system of value added tax

³¹ IANNONE F., *Le zone franche per il libero scambio*, ItaliaMondo - Logistica & Intermodalità, n. 88, 2006, p.29

³² Because it is possible to postpone the payment of customs duties until the goods exit from the free zone

³³ IANNONE F., *Le zone franche per il libero scambio*, ItaliaMondo - Logistica & Intermodalità, n. 88, 2006, p.30

b) Fulfilment of customs formalities when goods leave the free zone³⁴.

Over time the Regulation EEC 2913/92 has been modified by many legal deeds such as the Regulation (EC) no. 82/97 of the European Parliament and of the Council of 19th December 1996 amending Regulation (EEC) no. 2913/92 establishing a Community Customs Code; the Regulation (EC) no. 955/1999 of the European Parliament and of the Council of 13th April 1999 amending Council Regulation (EEC) no. 2913/92 with regard to the external transit procedure; the Regulation (EC) no. 2700/2000 of the European Parliament and of the Council of 16th November 2000 amending Council Regulation (EEC) no. 2913/92 establishing the Community Customs Code and the Regulation (EC) no. 648/2005 of the European Parliament and of the Council of 13th April 2005 amending Council Regulation (EEC) no. 2913/92 establishing the Community Customs Code³⁵.

2.3 Should Free Zones be considered as unfair competition? Compatibility with State Aid

According to the Community regulatory framework, the creation of a Free Zone is beyond the prerogatives reserved for individual Member States. The introduction of certain sets of measures in favour of certain companies such as investment grants, taxes and social charges, in fact, can constitute a hypothetical State aid and must be judged in light of the specific discipline of the topic.

The relevant legislation is the article no. 107 of the Treaty on the Functioning of the European Union (TFEU). The paragraph no. 1 establishes that «any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market».

However, the paragraph no. 2 identifies some types of aids that are always compatible with the internal market:

³⁴ BUCCICO C., *Il fondamento giuridico delle zone franche urbane e l'equivoco con le zone franche di diritto doganale*, Diritto e pratica tributaria, 2008, p.112

³⁵ BUCCICO C., *Il fondamento giuridico delle zone franche urbane e l'equivoco con le zone franche di diritto doganale*, Diritto e pratica tributaria, 2008, p.107

- a) «Aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
- b) Aid to make good the damage caused by natural disasters or exceptional occurrences;
- c) Aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division».

Moreover, other types of aids may be considered to be compatible with the internal market according to the paragraph no. 3:

- a) «Aid to promote economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of regions referred to in Article 349³⁶, in view of their structural, economic and social situation;
- b) Aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
- c) Aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
- d) Aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;
- e) Such other categories of aid as may be specified by decision of the Council on a proposal from the Commission».

According to article no. 108, paragraph no. 3 «the Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the internal market having regard to Article 107, it shall without delay initiate the procedure provided for in paragraph 2³⁷.

³⁶ Guadeloupe, French Guiana, Martinique, Réunion, Saint-Barthélemy, Saint-Martin, the Azores, Madeira and the Canary Islands.

³⁷ If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the internal market having regard to Article 107, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission.

The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision».

In other terms, all measures established for free zones that constitutes State aid must be notified by the respective Member State in order to obtain the approval of the European Commission³⁸, unless they fall under the *de minimis* regulation. According to the Regulation no. 994/98/EC certain categories of aid can be exempted from the notification requirement: aid for small and medium-sized enterprises, research and development, and aid that complies with the map approved by the Commission for each Member State for the granting of regional aid. The *de minimis* rule was introduced to exempt small aid amounts. It sets a limit below which aid is deemed not to fall within the scope of Article 107(1) TFEU and is therefore exempt from the notification requirement stated in Article 108(3) TFEU. The mentioned limit is equal to no more than €100,000 granted over a period of three years. This limit was then adjusted by the Commission Regulation no. 1998/2006/EC of 15th December 2006 and set to €200,000.

The latest modifications are the “Opinion of the European Economic and Social Committee on the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: EU State Aid Modernisation” of 2012 and the “Commission Regulation (EU) no. 651/2014 of 17th June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the TFEU”³⁹.

These two acts state that the European Commission can consider an aid compatible with the internal market if the following criteria are satisfied:

- A state aid measure must pursue at a purpose of common interest⁴⁰;
- Need of state intervention in situations in which it can bring an improvement that the market alone cannot provide;
- Aid limited to the minimum needed for the purpose of stimulating additional investments or activities in the area;

³⁸ DE JONG, W., *Establishing Free Zones for regional development*, Library of the European Parliament, 2013, p.3

³⁹ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.9

⁴⁰ NICOLAIDES P., *State Aid Modernization: Institutions for Enforcement of State Aid Rules*, World Competition, no. 3, 2012, p.464

- Transparency of aid in the sense that all economic operators and institutions must have easy access to all relevant documents and information concerning the granting of the aid;
- Negative effects on competition and trade between Member States must be limited⁴¹.

After this analysis, it is possible to affirm that the tax reliefs granted in free zones and free warehouses don't constitute, in the majority of the cases, a state aid as they don't distort or threaten to distort competition. In fact it is possible to state that in a certain way this kind of advantages are a derogation of the article no. 107 of the TFEU.

An interesting example is Poland. Investors benefit from incentives to locate their activities in 14 Special Economic Zones (SEZs), each consisting of several sub-zones. SEZs were introduced in 1994 as part of regional policies to fight high structural unemployment in some peripheral areas. Benefits consist of tax holidays, assistance in handling formalities, availability of land at below-market prices and real estate tax exemptions. Before Poland's membership in the European Union, the incentives provided in the SEZs became the source of heated debates between the Polish authorities and the European Commission, which believed that the measures induced unfair competition. In 2001 regulations on SEZs were harmonised with EU legislation on state aid. Tax benefits were substantially reduced. The rules for granting aid for enterprises which had received authorisation before 2001 were determined in the Treaty of Accession. In 2007 state aid in SEZs was adjusted to the Guidelines for state regional aid for the years 2007-13 issued by the European Commission⁴².

Recently the European Union has investigated tax concessions and guaranteed exemptions of the Madeira Free Zone in Portugal. More in detail, in 2007 Portugal presented a notice concerning the facilities that could have been in contrast with the state aid legislation for the period starting from 1st January 2007 to 31st December 2013. The European Commission approved these measures on the basis of the guidelines on regional state aid for the period 2007-2013. In fact, these advantages were considered to be a compatible operating aid aimed at promoting regional development and diversifying the economic structure of Madeira considered as an outermost region pursuant to article no. 349 of the TFEU.

⁴¹ EUROPEAN COMMISSION, *Communication from the Commission: Guidelines on State aid to promote risk finance investments*, 2014, p.18

⁴² OECD, *OECD Economic Surveys: Poland 2010*, OECD Publishing, 2010, p.46

Therefore, companies registered and authorized under the scheme before 31st December 2013 would have benefited from the tax advantages in question until 31st December 2020.

These tax advantages were intended to offset the additional costs of carrying out the economic activity of the companies in that region resulting from its structural disadvantages.

The Commission authorized aid in the form of a reduction in the corporate tax rate on profits from activities actually and materially carried out in Madeira, exemption from municipal and local taxes as well as exemption from taxes on real estate transfers for starting up a business, up to maximum aid amounts established on the basis of company incomes and of the number of jobs created.

In 2013 the tax advantages previously approved were re-confirmed with the sole difference that the amounts of aid were increased.

Following the control operations carried out in 2015 based on the information presented by Portugal, the Commission decided to carry out more in-depth checks because it claims that the aid was not applied in accordance with the 2007 and 2013 decisions.

In fact, according to the Commission it was necessary to carry out an investigation into the origin of the profits to which the deduction was applied because it appeared that Portugal has not applied the tax deduction to profits generated by activities actually and materially carried out in the region. In addition to this, the checks also concerned the creation and actual maintenance of jobs that generated the tax advantage granted to the beneficiaries since the Commission claims that:

- the employees who had only worked for part of the year were considered in full use tax;
- the employees and members of the boards of directors have been considered as valid employees in more than one beneficiary company; and
- for the calculation of the creation of jobs that gave access to the tax deduction, the employees in service outside the Madeira and even outside the EU have been considered.

On the basis of these premises, therefore, the regime implemented by Portugal cannot fall within the scope of the Commission approval decisions of 2007 and 2013.

Consequently, the regime implemented by Portugal constitutes illegal aid, since it was put into act in breach of Article 108 (3) TFEU.

Furthermore, state aid guaranteed in the areas of Madeira cannot be considered compatible either with the internal market or with Article 107 (3) (a) of the TFEU, since it appears that Portugal has applied the regime according to modalities that have not helped to remedy the structural disadvantages that the companies that carry out their activities in Madeira can actually find themselves facing⁴³.

⁴³ OFFICIAL JOURNAL OF THE EUROPEAN UNION, *State Aid — Portugal — Zona Franca da Madeira (ZFM) — Invitation to submit comments pursuant to Article 108(2) of the Treaty on the Functioning of the European Union*, 2019

CHAPTER III

3.1 Free Zones in Italy

The main types of free zones in Italy are three: the Customs Free Zones, the Urban Free Zones and the Zero Bureaucracy Zones.

The purpose of the Customs Zones is essentially to facilitate trade in goods by suspending the application of customs laws, reducing unemployment, especially youth unemployment, and speeding up the economic development of the territories in question.

Alongside the customs free zones, on 28th October 2009 the Italian government gave the green light to the creation of the so called Urban Free Zones, identified for the first time in France in 1996, which also represent a valid tool for the local development of particularly degraded areas.

This new measure was designed, starting from the 2007 Budget Law¹, in order to "promote the economic and social development of the weakest urban neighbourhoods, with the potential for unexpressed expansion, and for the creation of new jobs"².

UFZs are infra-municipal areas with a minimum pre-established dimension where programs that provide an advantageous taxation are concentrated in order to stimulate and strengthen entrepreneurial and occupational growth in newly established small businesses and, to a lesser extent, also in companies already operating in the same areas³.

In this second type of free zone, the element that distinguishes them from the others is the concentration of tax exemption programs for the creation of micro and small businesses, in order to favour the economic and social development of neighbourhoods and urban areas characterized by social and economic hardship and employment.

Finally, the Zero Bureaucracy Zones were initially planned only for the South of Italy, while then the possibility of creating them was extended to the whole national territory.

In this third category of free zone the predominant element is the reduction of bureaucratic burdens, considered one of the main causes of the poor recovery of the Italian economy. Furthermore, this type of area was designed to encourage new

¹ Law no. 296 of 2006

² GRAUSO R., *Zone franche urbane e defiscalizzazione: un'occasione di rinascita*, Iusinitinere, 2017

³ DE LEO D., *ZFU: prove di innovazione per i quartieri deboli*, *Urbanistica Informazioni*, 2011, n. 227/228, p.

production initiatives, through the streamlining of administrative proceedings administrative proceedings initiated ex officio, excluding those of fiscal nature, public security and public safety⁴.

Actually, this tool is recognised by the law, even if it was declared partially unconstitutional with the sentence no. 232 of 22nd July 2011 in the part in which it was intended to apply also to the administrative procedures that took place within the sphere of the issues of regional competence, but it has never been put into practice⁵.

In Italy there are the free zones of Livigno, Campione d'Italia, Valle d'Aosta⁶ and Gorizia⁷, established by the art. 2 of the Consolidated Law on Customs, which was the reference law before the Community Customs Code.

Other important free zones are the free ports of Trieste and Venice⁸, which will be discussed in the next paragraphs, together with the ports of Gioia Tauro and Taranto.

The free zone of the port of Gioia Tauro was the first “not landlocked” free zone in Italy, established by the Customs Agency on 1st August 2003. From the beginning it has represented a model with unique and tailor-made features: it is integrated with the territory, so as not to be surrounded by boundaries and access points imposed by the State with the consequent access control options typical of the traditional Free Zones. In fact, the free zone that was established in 2003 in the port of Gioia Tauro as of type II, which means that it does not need fences and in it customs controls are carried out in a simplified manner⁹. Indeed, also in this case simplified customs obligations were adopted and applied according to the deposit regime. Companies that can take advantage of the free zone benefits of the port of Gioia Tauro can import from non-EU countries to the EU without paying duties and with tax suspension. The opportunity that refers to the so called “last mile processing” is evident: importing raw materials from

⁴ Article no. 43, Law Decree no. 78 of 31st May 2010, converted with amendments by the Law of 30th July 2010, n. 122 (Urgent measures concerning financial stabilization and economic competitiveness)

⁵ COLOMBO D., *Zone a burocrazia zero? Ci hanno provato tre governi e hanno fallito. Ecco cosa è successo*, Il sole24ore, 2014

⁶ Article no. 14 of the Constitutional Law no. 4 of 26th February 1948

⁷ Article no. 1 of the Law no. 1438 of 1st December 1948

⁸ Both these free zones are Control Type I, which means goods placed within the perimeter fence that is monitored by customs, are automatically under the free zone regime

⁹ CAMERA DEI DEPUTATI, Act 1272 - 17th Legislature, Bill: Provisions concerning the establishment of Special Economic Zones in logistic-industrial areas connected to ports of international importance, 2013

abroad, temporarily suspending the payment of customs duties, and after the transformation or assembly of goods, re-export without paying duties¹⁰.

It should be emphasized that the Free Zone of Gioia Tauro, however, has never been the object of formal and definitive communications from the National Authorities to the European Commission¹¹ and has therefore not been included in the list periodically published in the Official Journal of the European Union.

Recently, with the entry of the new Customs Code type II free zones and free warehouses have been cancelled. Type II free zones and free warehouses existing as of 1st May 2016 must be processed by 1st May 2019 in customs warehouses¹².

The Code now provides, in art. 243, a single type of free zone, the one interspersed, in which the perimeter and the points of entry and exit are subject to customs supervision. The Free Zone of Taranto - established in the port area - has been classified as "not landlocked" with the aim of facilitating the simplified operation of import/export activities without the payment of any duty for movements carried out within the perimeter¹³. The project was born as a pilot model that could be replicated in other district areas, whose main characteristic is, obviously, the simplification of customs procedures for companies oriented towards foreign trade. The reference subject has been identified in an exclusive manner in the Port Authority of Taranto, the interlocutor with which all operators who request to use the facilitated EU regime for the handling of foreign goods must interact. It is of particular importance for potential development the opportunity offered to depositors to manage the production and transformation of goods located within the free zone without the effects of indirect national and EU taxation (duties, excise duties and VAT). The free zone of Taranto has been classified in some cases as a hybrid model, as it identifies properly the discipline of the Free Zone and the more "flexible" one of the customs warehouse. It is in this way that only the Port Authority interacts with the Customs, which manages the entire dedicated area through the "warehouse accounting" relating to the deposit regime¹⁴.

¹⁰ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.20

¹¹ Art. 243, Regulation (EU) no. 952/2013 of the European Parliament and of the Council of 9th October 2013 laying down the Union Customs Code

¹² FABIO M., *Manuale di diritto e pratica doganale*, IPSOA, 2016, p.649

¹³ PALMIOTTI D., *Il Porto di Taranto ottiene la Zona franca doganale*, Il Sole24ore, 2014

¹⁴ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.21

The common incentives of Italian free zones could be identified among the following tools:

- capital contribution payment for the realization of the initial investments connected to the productive settlement;
- customs facilities, by suspending the payment of value added tax and duties, with simplification of customs procedures;
- exemption or reduction of local taxes related to real estate, taxes related to waste disposal, indivisible services;
- exceptions to the regulations on employment contracts;
- exemptions or reduction of social security contributions;
- infrastructural interventions in the territory concerned, in order to improve competitiveness also in terms of logistics and cargo handling;
- tax exemption: total or partial reduction of IRAP and IRES¹⁵.

3.2 Free zones as national tax regime

Italy, as one of the Member States of European Union, must observe the prevailing EU law as regards Customs Free Zones.

From 1st January 1993, with the creation of the European Single Market, all the internal customs laws fell and a single code was created, whose future evolution can only be established by the Community bodies expressly appointed for this purpose¹⁶.

The Community Customs Code and the subsequent Application Provisions constitute the basis of the economic union between the different Member States, which represent a single complex vis-à-vis all other countries defined as "third parties" with respect to those of the European Union. The Community Customs Code is therefore the only legislative instrument, valid for all the countries of the Community and, by providing identical rules and procedures for all member countries, it is the only fundamental customs law existing for the European Union for the exchanges to be carried out with the Countries not belonging to the Single Market and belonging to different economic areas. It is composed of 253 articles that organically govern the vast area of community customs intervention starting from the field of application and from the basic definitions

¹⁵ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.15

¹⁶ NICALI A., FAVALE G., *La dogana nella storia. Profili storici di politica doganale e commerciale in Europa e nel mondo*, De Luca Editori d'Arte, 2004, p.64

of the customs activity up to the operating principles and the related implementing rules.

The new Community Customs Code (CCC), which has entered in force since 1st May 2016, as the previous Code regulates all the aspects of customs operations taking place in the European Union and lists the general principles on which the Community customs law is based. The operational details are instead described in the Application Provisions of the CCC.

As mentioned, before the establishment of the Community customs law, each Member State had its own specific customs law; currently some parts of this local legislation are still in force and regulate local situations that are not in contrast with the community law. In Italy the pre-existing customs law to the Community law was the Consolidated Law on Customs¹⁷ no. 43 of the 23th January 1973. Today, only the part concerning sanctions has remained in force¹⁸. In fact, the article no. 42 of the CCC states that “each Member State shall provide for penalties for failure to comply with the customs legislation. Such penalties shall be effective, proportionate and dissuasive. Where administrative penalties are applied, they may take, inter alia, one or both of the following forms:

- a pecuniary charge by the customs authorities, including, where appropriate, a settlement applied in place of and in lieu of a criminal penalty;
- the revocation, suspension or amendment of any authorisation held by the person concerned”.

Urban free zones, which refer to a more local dimension, derive from the French experience.

These kinds of zones are infra-municipal areas with a minimum pre-established dimension where tax relief programs are concentrated for the creation of small and micro enterprises. The priority objective of the UFZs is to favour the economic and social development of neighbourhoods and urban areas characterized by social, economic and occupational discomfort, and with unexpressed potential for development.

The establishment of the UFZs was initially envisaged by Article 1, paragraph 340, of Law no. 296 of 2006. The 2008 financial law (Law 244/2007, paragraphs 561, 562 and 563) has defined in greater detail the tax and social security benefits that, today, find

¹⁷ Consolidated text of customs provisions

¹⁸ DPR 43/1973, Titolo VII, CAPO I: CONTRABBANDO, artt. 282-301 bis

their definition within the inter-ministerial decree of 10th April 2013 in implementation of the provisions of art. 37 of the Legislative Decree no. 179 of 18th October 2012¹⁹.

These facilities consist of:

- exemption from income taxes;
- exemption from regional tax on production activities;
- exemption from municipal property tax;
- exemption from the payment of contributions on salaries from employment.

Small and micro enterprises²⁰ can benefit from the facilities if on the date of submission of the application:

- have the main office or local unit where the activity takes place within the ZFU;
- are regularly constituted and registered in the Business Register; and
- are in full and free exercise of their rights and they are not in voluntary liquidation or subject to bankruptcy proceedings²¹.

Therefore, Urban Free Zones constitute a particular and different facilitating regime in favour of the productive activities without an immediate involvement of the customs law.

The UFZ, as an application of a tax advantage measure, must be subject to both internal and external limits: the former are constituted by harmony with the Constitution and compliance with the principles of coordination of public finance and the tax system; in particular, the principles of equality, ability to pay, progressivity and the prohibition of double taxation emerge.

Article no. 53 of the Italian Constitution states that «every person shall contribute to public expenditure in accordance with their capability», that is, it is right that the whole population contributes to public spending if and according to what is in their ability to contribute.

Therefore, the solidarity function of the art. 53 of the Constitution takes the form of the involvement of "all" avoiding, in general, distinctions, but under this principle,

¹⁹ CAMERA DEI DEPUTATI, Documentazione parlamentare, *Le attuali zone franche urbane*, 2019

²⁰ For the former we mean companies with an annual turnover of less than 2 million euros and less than 10 employees and for the latter, companies with less than 50 employees and an annual turnover less than 50 million euros

²¹ MINISTERO DELLO SVILUPPO ECONOMICO, *Zone Franche*, 2019

discriminations between persons are admitted if justified by the aims of economic and social solidarity.

The economic policy often requires adaptations to the particularities of economic situations, and margins of flexibility that make it appropriate to articulate the tax levy differently despite the presence of a taxable fact similar to those subject to full taxation. Periodically, productive sectors, or territorial areas, or certain goods, deserve a benevolent consideration of the fiscal legislator, also because it is recognized that the fiscal lever, used in incentive function, can constitute a great factor of development and an element of well-being also for the subjects not directly addressing the relief.

Obviously, the Constitutional Court will be able to assess, in individual cases, whether each facilitation is detrimental to the principle of contributory capacity as an irrational one, and in any case respects the principle of equality which requires equal treatment only on equal terms²².

The external limits derive from the respect of the principles of neutrality and non-discrimination enshrined in the Treaties of the Union.

In particular, to judge the legitimacy of the tax benefits recognized by the Member States to companies or to certain production sectors, particular disadvantageous criteria must be taken into consideration, whose evaluation would allow the interpretation of the aid, not as an element of distortion of free competition, but as a compensatory and transitory remedy for a productivity inequality encountered by the economic subjects operating in certain realities. On the other hand, one of the objectives of the EU coincides with the tendential zeroing of the gap between the different levels of development of the Member States²³.

The aid in question is financed from the public budget. This aid is selective as it is intended for small and micro enterprises located in the UFZ (with the exclusion of the rest of the Italian territory). The aid in question threatens to distort competition and affects trade between Member States in so far as it favours certain undertakings which could carry out commercial activities at Community and international level²⁴.

Therefore, this aid must be analysed in the framework of Article 107 of the Treaty on the Functioning of the European Union.

²² BASILAVECCHIA M., *Corso di diritto tributario*, Giappichelli, 2017, p.17

²³ BARABINO P., *Le Zone Franche Urbane in Italia: un primo risultato dell'esperienza sarda*, Rivista trimestrale di diritto tributario, 2014, fascicolo 4, p.817

²⁴ KROES N., Communication from the European Commission dated 28/10/2009, C (2009) 8126, State aid No. 346/2009- Italy, Urban free zones, p.5

The aid to which the guidelines on regional state aid apply is aimed at promoting the economic development of disadvantaged areas, while the UFZ regime intends to fight against social exclusion in disadvantaged urban areas²⁵. In fact, the zones eligible for the ZFU scheme are selected on the basis of a synthetic index which incorporates the following criteria:

- unemployment rate;
- employment rate;
- rate of population under the age of 24 on the total population;
- level of schooling²⁶.

Between the two regimes, the following differences can be noted:

- for regional state aids territorial scales are used which are always higher than those of the UFZs, which instead concern very specific disadvantaged areas, that is micro-territories (with less than 30 000 inhabitants, sometimes less than 10 000 inhabitants)
- the nature and form of the aids are different: regional state aids essentially take investments into account, while aid provided by UFZs are not based on investment, but are granted in the form of tax exemptions and contribution exemptions;
- in the practice of Member States, state aid granted with regional purposes is destined mainly for large and medium-sized enterprises, while the UFZ scheme is aimed at small and micro enterprises which are started or developed according to the definition of Community SMEs²⁷.

The Commission considers that the notified measures do not exactly coincide with the regional aid guidelines, although there may be a partial overlap.

The Commission is inclined to conclude that the tax exemption and social security exemption measures borne by the company do not fall within the scope of the existing guidelines and regulations based on article 107 of TFEU.

²⁵ All the UFZs selected for the final list show a positive socio-economic hardship index. In other words, the UFZs are areas of concentration of socio-economic problems for which public intervention is necessary.

²⁶ KROES N., Communication from the European Commission dated 28/10/2009, C (2009) 8126, State aid No. 346/2009- Italy, Urban free zones, p.5

²⁷ KROES N., Communication from the European Commission dated 28/10/2009, C (2009) 8126, State aid No. 346/2009- Italy, Urban free zones , p.6

Indeed, article 107(3)(c) permits the granting of aid to facilitate the development of certain economic activities or of certain economic areas, provided that such aid does not adversely affect trading conditions to an extent contrary to the common interest and article 107(3)(a) permits aids to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment in view of their structural, economic and social situation.

The Commission therefore considered it appropriate to check the extent to which the notified measures:

- 1) aim to achieve a Community objective;
- 2) are necessary and proportionate to achieve this objective; and
- 3) do not alter the conditions of trade to an extent contrary to the common interest.

In conclusion, the Commission considered that the measures under examination were not such as to alter trading conditions to an extent contrary to the common interest and that the effects on trade would be very limited²⁸.

As regards Zero Bureaucracy Zones, the first attempt to establish them was in 2010.

It starts with article 43 of the Legislative Decree no. 78 of 2010. The new productive initiatives that would be born in areas with zero bureaucracy should enjoy the following advantages: the conclusive provisions of administrative procedures of any nature initiated on the request of a party (excluding those of a fiscal nature, public security and public safety) are exclusively adopted by a Government Commissioner; after thirty days from the start of the procedure, in the event of failure to adopt the express provision, silence will be granted. The ZBZs were to be established by a decree of the President of the Council of Ministers, on the proposal of the Minister of Economy, in agreement with the Minister of the Interior. Moreover it was foreseen that, if the ZBZs in Abruzzo, Basilicata, Calabria, Campania, Molise, Puglia, Sardinia or Sicily were to coincide with one of the urban free zones identified by the Inter-ministerial committee for economic planning resolution no. 14/2009, the resources foreseen for these ZFU would have been used by the mayor for the granting of direct contributions to the new productive initiatives started in the ZBZ. In 2011, however, the Committee declares the ZBZ

²⁸ KROES N., Communication from the European Commission dated 28/10/2009, C (2009) 8126, State aid No. 346/2009- Italy, Urban free zones, p.10

regulation²⁹ to be illegitimate in that it also applies to administrative procedures concerning matters of concurrent and residual regional competence.

In 2011 the government made a second attempt. It starts with the 2012 Stability Law no. 183/2011: the Government Commissioner was replaced by the local Government Office, set up in each provincial capital, at the request of the Region, in agreement with the interested bodies and on the proposal of the Minister of the Interior, by decree of the President of the Council of Ministers. The local Government Office is meant to be presided over by the prefect and composed of a representative of the Region, a representative of the Province, a representative of the Metropolitan City (if any) and a representative of the Municipality concerned. The new ZBZs are rethought experimentally until the 31st December 2013 throughout the territory. But the implementing measures will never arrive and everything is cancelled with the legislative decree no. 179 of 2012. This decree now provides for the possibility of identifying ZBZs in the context of experimentation initiated on the basis of specific conventions provided for by the "Semplifica Italia" decree.

These conventions establish that "Regions, Chambers of Commerce, Municipalities and their associations, business agencies, competent administrations and interested trade organizations and associations, can activate experimental simplification paths for production plants and companies in delimited areas".

These conventions could have identified ZBZs in areas not subject to landscape-territorial constraint or historical-artistic heritage. The simplified administrative procedures would have concluded electronically. Even here, the silent consent was provided 30 days after the start of the company requests, always excluding tax, of public health and safety proceedings. Unfortunately, these conventions have never been pledged.

Successively, the government approved the Legislative Decree no. 69/2013 that foresaw the extension of the experimentation activities to the whole national territory and the adoption of a National ZBZ Plan. But the Plan has not yet started³⁰.

Recently, Italy has created "free-trade zones" within its harbour areas. The Special Economic Zones (SEZ) are designed to attract investors to the harbours of southern Italy and the logistic areas behind them. As a matter of fact, Italy was one of the few European

²⁹ Sentence no. 232 of 22nd July 2011

³⁰ COLOMBO D., *Zone a burocrazia zero? Ci hanno provato tre governi e hanno fallito. Ecco cosa è successo*, Il sole24ore, 2014

Union Member States, up to now, that lacked such instruments conceived for territorial promotion which are very common in Eastern countries, or in the countries overlooking the Baltic Sea, such as Poland, which has many SEZs.

SEZs are, therefore, geographically limited and clearly identified areas in the Southern regions, in which companies can benefit from special incentives (tax and regulatory, in the form of tax credit and administrative simplifications) aimed at creating more favorable conditions for investments and territorial development. SEZs will be concentrated in port areas and in areas that are economically linked to them and can be activated at the request of the southern regions concerned, subject to an appropriate development project.

The green light was given in February 2018, as soon as the Italian Prime Minister's decree was published in the Official Journal of the Republic of Italy. The courses of action for the creation of SEZs were launched in June 2017 with the so-called "Decree for the South"³¹ that was converted into law in August 2017, and eventually enacted in January 2018 by the Decree no. 12 of 25th January 2018 about the Regulation on the establishment of the Special Economic Zones (SEZ).

According to art. no. 4, paragraph no. 2 of the Decree "the SEZ is defined as a geographically defined and clearly identified area, located within the boundaries of the State, also consisting of non-territorially adjacent areas provided they have a functional economic link, and which includes at least one port area with the characteristics established by Regulation EU no. 1315 of 11th December 2013 of the European Parliament and of the Council, connected to the Trans-European Transport network (TEN-T). For the exercise of economic and entrepreneurial activities, the companies already operating and those that will settle in the SEZ can benefit from special conditions, in relation to the incremental nature of the investments and the development activities of the company."

Moreover, proposals for the establishment of a SEZ can be presented by less developed and transition regions, as identified by European legislation, eligible for the exceptions provided for in Article 107 of the Treaty on the Functioning of the European Union³².

Article no. 4, paragraph 5, provides, instead, that the proposal must be accompanied by a strategic development plan, in compliance with the methods and criteria identified by

³¹ Law Decree no. 91 of 20th June 2017

³² Article 4, paragraph 4, Law Decree no. 91 of 20th June 2017

the recently approved implementation regulation. The region makes the proposal specifying the characteristics of the identified area.

Until today, two SEZs have been established³³ in the regions of:

- Campania, in the harbour district composed of Naples, Salerno and Castellammare di Stabia; and
- Calabria, in the harbour district of Gioia Tauro³⁴.

The benefits that companies settled in a SEZ may enjoy are of three types:

1. tax credit for companies initiating their economic activities or investments in special areas consisting of harbours, airports and surrounding areas, logistic platforms and harbour facilities. The tax credit corresponds to 20 per cent of investments (limited to a maximum of €50 million) for small undertakings, 15 per cent for average businesses and ten per cent for large companies, unless different rates are applied in certain areas;
2. faster procedures and timing for the release of authorisations; and
3. reduced administrative and submission charges.

The requirements for benefiting from tax relief and simple procedures are:

- the beneficiary companies must maintain their activity in the SEZ area for at least seven years after the completion of the investment subject to the facilitations, under penalty of revocation of the benefits granted and enjoyed; and
- no order of winding-up or dissolution allowed³⁵.

Between the decree-law establishing the Special Economic Zones and the approval of the implementing regulation, the reflection on the facilitations at the Northern ports gave rise to a special measure, destined to the so-called “Simplified Logistics Zones”, approved with an amendment made with the Law of 2018 Financial Statements³⁶, published in the Official Gazette no. 302 of 29th December 2017, which provides, in fact, the establishment of port areas in which companies will be able to benefit from some simplified procedures already granted to Special Economic Zones. The text specifies that in each Region no more than one Simplified Logistics Zone can arise and that the latter can only arise in the Regions that have at least one port area with the characteristics established by EU Regulation 1315/2013, or in which the Port Authority is present.

³³ The relevant constitutive decrees were signed on 11th May 2018

³⁴ DIALTI F., *Special Economic Zones finally established by Italy*, IBA Digital Content, 2018, p.1

³⁵ DIALTI F., *Special Economic Zones finally established by Italy*, IBA Digital Content, 2018, p.2

³⁶ Law no. 205 of 27th December 2017

The Simplified Logistics Zone will have a duration of seven years, renewable for another seven and will be adopted on the proposal of the Ministry for Territorial Cohesion in concert with that of Transport. For its institution the procedures already envisaged for Special Economic Zones are applied³⁷.

The main and not marginal difference with respect to the SEZs is that the SLZs, located in the centre and in the north of Italy, do not enjoy the tax benefits provided for the former such as the tax credit for the purchase of new capital goods. The companies operating in them, therefore, will only benefit from simplified procedures that is the acceleration of the procedural terms and requirements and special procedures.

3.3 The case of the Trieste port

The Free Port of Trieste represents a peculiar case in the Italian and Community legal system, especially in consideration of the historical-political events that marked its establishment and, more generally, that affected the territory of Trieste³⁸.

The 1947 Paris Peace Treaty, the provisions of Annex VIII³⁹ and the Memorandum of London in 1954 maintained the Free Port of Trieste's legal and fiscal regime, thus giving it an extra-territorial status. Since that time, customers can benefit from special conditions for both import, export and transit operations, customs procedures and fiscal regime.

The special regime of the Free Port is recognized also by Italian Customs Law (Presidential Decree n. 43/73) which, at art. 169, expressly refers to Annex VIII of Paris

Figure 1: The Free Port of Trieste.



Source: www.porto.trieste.it

³⁷ ANIELLO V., *Zone economiche speciali e zone logistiche semplificate, Misure per lo sviluppo dei porti ed elementi per una valutazione d'impatto*, 2018, p.9

³⁸ Historically, first under the Austro-Hungarian Empire until 1918, and then under the Kingdom of Italy, the Port of Trieste has always benefited from particular prerogatives from the legal and organizational point of view, which have enhanced the nature of a place delegated to implementation of international trade in a strategic geographical area. Reference should be made to the years following the Second World War when the Free Port of Trieste assumed an international dimension through the Peace Treaty between Italy and the allied and associated powers.

³⁹ They shall be considered still in force and shall be regarded as the primary source of law and the basis of the international status of the Free Port of Trieste

Peace Treaty and states that “Customs Law shall not affect any existing most favourable provision concerning the free zones of the port of Trieste”⁴⁰.

The international function of the Free Port of Trieste, which currently comprises five distinct free areas, three of which are for commercial activities⁴¹ and two for industrial activities⁴², is “to ensure that Trieste's port and means of transit can be used in conditions of equality from all international trade according to the customs in force in the other free ports of the world”⁴³.

The Free Port of Trieste is political territory of the Italian State. Italian and European Union laws cannot, however, restrict the freedoms relating to customs duties and operations guaranteed by the Peace Treaty and its instruments of implementation. The legal status of the Free Port of Trieste is essentially embodied in two regimes: unrestricted access and transit and customs clearance exemption⁴⁴.

Considering the so-called safeguard clause pursuant to art. 307 of the EU Treaty, the Free Port of Trieste, intended as the sum of its free areas, is the only Free Zone located in the EU that enjoys a special regime, more favourable than the more restrictive one set by the Community Customs Code for the areas and free warehouses.

The perimeter of the Free Port of Trieste includes the majority of port areas and can be redefined or extended if necessary in the interest of commerce and port economic development⁴⁵

This particular status is due to a series of strategic advantages:

- right of entry without discrimination of ships and goods, whatever their destination, origin and nature, with the possibility of staying for an indefinite time; exempt from duties, taxes or other charges other than the payment for services rendered, without the need for authorization to disembark, embark, tranship, move and deposit and without the obligation to give a customs destination to the same goods, being able to be chosen by the operator at a later time;
- prohibition of customs interference (and therefore of customs control on goods entering and leaving the free areas, which takes place only at the gates) in the

⁴⁰ GREGORI M., *The Free Port of Trieste: an Analysis of the Current Legal Framework*, 2018, p.339

⁴¹ Old Free Zone, New Free Zone and Timber Terminal Free Zone

⁴² Mineral Oil Free Zone and Industrial Free Zone

⁴³ Article 1, Annex VIII: Instrument for the Free Port of Trieste, Treaty with Italy, 1947

⁴⁴ Port Network Authority of the Eastern Adriatic Sea, Free Port, Porto of Trieste website

⁴⁵ Article 3 of Annex VIII and article 16 of Decree n. 29/55

operations of unloading and loading the goods, except for specific exceptions provided for by economic, health and public security (some goods such as monopolies, weapons, narcotics, pocket items, must be placed in special warehouses supervised by the custom authority). The exit of Community goods from the customs territory must be considered to have occurred at the time of the passage of the customs gates and the introduction of Community goods in Trieste free areas constitutes an export tax transaction which is not subject to VAT;

- no time limit for goods storage;
- no customs formalities to be completed until the goods remain in the free areas;
- no customs duties to be paid or guarantee until the goods are in the free areas;
- reduced port taxes compared to other national ports;
- simplified transit for commercial vehicles in transit to and from the Port of Trieste and dispatched for abroad;
- simplified customs system for the transit of goods by rail;
- possibility of manipulation (e.g. packaging, repacking, labelling, sampling, elimination of brands, etc.) and transformation of goods, even of an industrial nature, completely freedom from any customs obligation;
- application of the institute of the so-called "customs credit", which entails the right, for goods imported into the Community market through the free ports, to pay the related customs duties and taxes with delay up to 6 months after the date of customs clearance at a particularly favourable annual interest rate (50% of 6M Euribor);
- possibility of performing mixes of any kind abroad for products subject to excise duties;
- possibility to change the customs status of the goods (foreign status, free EU practice without VAT payment, imported, exported, in transit), without the need for physical movement of the goods;
- possibility of the operator to take advantage, alternatively, of the institutions provided for by Community and/or national legislation (e.g. tax warehouses, VAT deposits), if more favourable, with the consequent respect of the conditions provided for these institutions;
- possibility of extending the free ports;

- application of the best practices in force in the other free ports of the world⁴⁶.

Recently, the Italian government with the Ministerial Decree of 13th July 2017 on “administrative organization and management of the free zones comprised in the Free Port of Trieste”, provided for in Law n. 84/94, has implemented the principles of freedom of access and transit of Annex VIII and subsequent national and international rules and has given the Port System Authority and, particularly, its President, the role of managing, controlling and coordinating institution of the Free Port of Trieste⁴⁷.

The Port System Authority authorizes the production, manipulation and industrial transformation of goods and the provision of services and determines the amount of concession fees for the use of assets and quays. The Authority governs the access to the Free Port and supervises security controls and everything that concerns the use and maintenance of the common areas of the port⁴⁸. It performs a coordinating role and ensures the industrial and commercial promotion of the port and, in particular, of its railway services in accordance with the principle of freedom of transit and access as laid down in Annex VIII⁴⁹.

Moreover, the Authority takes measures to modify and extend the area of the Free Port, in accordance with Annex VIII, where necessary to meet the needs of international trade or to guarantee compliance with international obligations undertaken by the Italian State⁵⁰.

The Authority also defines and implements the management planning of the Free Port aimed at fostering the growth of the maritime economy, traffic flow and transports and of the economic, social and environmental system. Such plans are directed to identify the relevant uses of the Free Port and to organize the distribution of economic and social activities in its area⁵¹.

One of the major issues concerning the legal status of the Free Port of Trieste is the relationship between EU legislation and the applicable rules of International Law which guarantee the Free Port a particularly favourable legal regime while, on the contrary, E.U. rules on customs, tax, and state aid severely restrict the creation of free zones.

⁴⁶ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.18

⁴⁷ GREGORI M., *The Free Port of Trieste: an Analysis of the Current Legal Framework*, 2018, p.340

⁴⁸ Article 3, paragraph 2, Ministerial Decree of 13th July 2017

⁴⁹ Article 3, paragraph 4, Ministerial Decree of 13th July 2017

⁵⁰ Article 3, paragraph 5, Ministerial Decree of 13th July 2017

⁵¹ Article 4, Ministerial Decree of 13th July 2017

Indeed there are some relevant differences between E.U. free zones and the Free Port of Trieste.

Firstly, according to EU law persons, goods and means of transport entering or leaving free zones may be subject to customs control⁵², while considering Free Port of Trieste customs control on goods entering and leaving the free area as well as on loading and discharging, deposit, trans-shipping and manipulation operations are generally not permitted.

As far as applicable law is concerned, the prevalence of the pre-existing international legal regime over the EU rules is stated by article no. 351 of the Treaty on the Functioning of the European Union according to which “the rights and obligations arising from agreements concluded before 1st January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties”.

Such principle, considered a rule of customary International Law, is expressed also at article no. 30, paragraph 2, of the Vienna Convention on the Law of Treaties according to which “when a treaty specifies that it is subject to, or that it is not to be considered as incompatible with, an earlier or later treaty, the provisions of that other treaty prevail”. Despite the Free Port of Trieste has not been formally excluded by the E.U. customs territory, the Union Customs Code includes at article no. 1, paragraph 1, an expressed safeguard clause which clarifies that the Code shall apply uniformly in every place of the customs territory of the Union “without prejudice to international law and conventions and Union legislation in other fields”.

Furthermore, it must be mentioned that in the past the adoption of some EU acts was accompanied by statements which recognized, in different ways, that the Free Port of Trieste is governed by the Paris Peace Treaty and by the Memorandum of London or which specified that such international agreements, stipulated before the Treaty of Rome, must be considered still legally binding and not affected by EU legislation.

Even if the content of such statements was never incorporated into the legislative acts themselves, it proves that the European Union considers the international legal regime of the Free Port not per se incompatible with EU Law.

⁵² Article 243 of Union Customs Code (Reg. E.U. 952/2013)

For the reasons mentioned above, it can be concluded that Annex VIII of the Paris Peace Treaty should prevail. Therefore the application of the Union Customs Code should be limited to the provisions not in conflict with the special legislation on the Free Port⁵³. Moreover, it can also be concluded that advantages granted by the Free Port of Trieste are not in conflict with the article no. 107 of TFEU and therefore they can't be considered state aids.

Table 1: Comparison of advantages between the Free Port of Trieste and other ports.

	Free Port of Trieste	Other national ports	Other free zones and/or free warehouses in Italy and EU
Landing of goods coming from abroad	Automatic acceptance in the free port, unlimited foreign state maintenance, no preliminary formalities required	Payment of import duties, customs check, payment of port fees	Transfer from quay to warehouse with T1, customs declaration of introduction, customs check, payment of port taxes, then maintenance of unlimited foreign status
Transit of foreign goods for foreign countries	Maintenance of unlimited foreign status, no customs formalities required	Transit declaration, guarantee on rights due, customs check	Customs declaration of introduction and transit with a guarantee, customs check
Landing of national and/or community goods	Faculty of maintenance of the national and/or community origin	Landing customs form	Normally not provided
Boarding of national/community goods for abroad	Customs export declaration at the introduction into the free port with immediate (optional) use of VAT plafond	Customs export declaration gathered to boarding, customs check at the boarding	Normally not provided
Industrial transformation of foreign goods for the foreign market	No customs formality and/or charge prior to a request of authorization for the production activity to the customs agency	Request for authorization to the customs agency, temporary declaration of import, customs check, guarantee on customs rights, statement of temporary processing, importation with customs document issuing for boarding	Request for authorization to the customs agency, introduction declaration, customs check, extraction with issue of customs documents valid for boarding, transfer from warehouse to quay with T1
Industrial transformation of foreign goods for the national and	Request for authorization for settlement of production activity to	Request for authorization to the customs agency, temporary declaration	Transfer from quay to warehouse with T1, request for authorization to the

⁵³ GREGORI M., *The Free Port of Trieste: an Analysis of the Current Legal Framework*, 2018, p.345-346

community market	the customs agency, no advance payment of customs rights, possibility of <i>MADE IN ITALY</i> acquisition, payment rights on raw materials used at 180 days	of import of raw materials, customs check, customs rights payment at 30 days, 90 day payment of VAT duty on raw materials used	customs agency, introduction declaration, customs check, customs rights payment at 30 days, 90 day payment of VAT duty on raw materials used
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Source: Dai Punti franchi vantaggi concreti per le imprese, www.porto.trieste.it, 2014

3.4 Venice Free Zone

The Venice Free Zone (VFZ) is the customs free area of the Port of Venice in Marghera, whose economic advantages can be mainly traced to the fact that goods from countries outside the European Union can remain in the Venice Free Zone maintaining the foreign status.

The free zone of Venice was formally activated on 1st July 2014 in the new location and delimitation identified by the Ministry of Economy and Finance in concert with the Ministries of Economic Development and Infrastructures and Transport, through the adoption of the inter-ministerial decree 22nd March 2013, published in the Official Journal n. 81 of 6th August 2013⁵⁴.

The introduction in the free zone, in fact, is a special customs destination that allows to store imported goods without time limits and without paying duty until a different customs destination is decided.

In particular:

- the duty will not be paid at the time of final export if the goods are destined for countries outside the European Union;
- the duty will be paid only upon release for free circulation if the goods are destined for the internal market of the European Union.

Consequently, the VFZ is also of great use when importers cannot immediately assign a particular customs destination to the goods.

In the VFZ the stored goods can be:

- object of manipulation (such as repacking, labelling, ventilation, dusting, pesticide treatments);
- bound by the inward processing regime for the goods to be re-exported;

⁵⁴ AGENZIA DELLE DOGANE E DEI MONOPOLI, *Comunicato stampa: attivato dal 1° luglio il punto franco di Venezia*, Prot. No. 75408/R.U., 2014

- subject to the regime of processing under customs control, a regime that allows for the import of non-EU goods to be processed by applying duties only when the final product is placed on the European market.

Since the goods introduced into the VFZ circulate in suspension of customs duties and are introduced in an interposed free zone, a guarantee deposit is not required.

It should be pointed out that the VFZ of Venice has been recognized as a "Community free zone with type 1 control" and, as such, requires less bureaucracy and paperwork compared to free zones with type 2 control.

In the area in question it is possible to consolidate shipments of goods that come from different origins (both EU and non-EU) and at different times, but which are destined for export together (for example in the case of assembly of large plants). This placement in the VFZ allows the regularization of the commercial documentation with the issue of the regular one-off export customs bill. It is also possible to sell goods in triangulation transactions between Italian assignor, non-EU assignor and Italian final purchaser without the need to transport the goods to the non-EU State and ensuring the regular sale of the first Italian assignor⁵⁵.

Despite the disadvantaged position, the Venice Free Zone is to be considered important because of the Belt and Road Initiative. In fact, the Chinese government has repeatedly designated the port of Venice as the point of arrival in Italy, since the maritime route coming to Venice appears to be the most efficient, due to the possibility of minimizing the time and costs related to handling of the goods. Moreover, the Port of Venice occupies a strategic position at the crossroads of two European corridors, the Baltic-Adriatic and the Mediterranean, and near the Scandinavian-Mediterranean corridor that crosses Verona and Bologna. The European Commission has recognized the Port of Venice as a node as well as a sea and river port of the priority network.

⁵⁵ DE LUCA R., *Le zone economiche speciali: caratteristiche, agevolazioni, opportunità e aspetti operativi*, Fondazione nazionale dei commercialisti, 2017, p.19

CHAPTER IV

4.1 Free Zones in the world

In 2017, the number of active free zones in more than 80% of states in the world was 2198¹.

Free economic zones are growing in size and number across the world. It is important to underline that these FTZs are helping to expand international trade, but they are also havens for illicit trade.

An example is Canada which has implemented three main FTZ-like programs: the Duty Deferral Program, the Export Distribution Program, and the Exporters of Processing Services Program. Each of these programs offers key advantages and benefits for businesses such as upfront relief of duties and taxes, refunds of duties for exported goods and deferment of duties and taxes².

Other example is South America. The first country that established the Free Zones regime was Uruguay in 1923, followed by Panama in 1948 and Colombia in 1958. It is interesting to see that the introduction of the free regime in Latin America it occurred mainly in two time periods.

The first one took place in the decades of 60's and 70's and there countries like Mexico, Brazil, Chile and the Dominican Republic adopted it. The second occurred in the 90's where countries such as Guatemala, Costa Rica, Argentina, Paraguay and Nicaragua started use this tool to encourage foreign trade.

Colombia stands out as the Latin American country with the greatest number of free zones in the region, having 102 in total. Colombia is followed by the region of Central America where countries as Republic Dominican Republic have 55 Free Trade Zones, Nicaragua 49 and Honduras 43. Other countries follow such as Guatemala with 24, Costa Rica with 23, and El Salvador and Panama with 17 respectively. Other countries in the region, Chile, Paraguay and Ecuador have only one or two free zones³.

The largest number of companies operating in Zona Franca is located in Chile, where about 2 850 companies operate in the two Free Zones of the country. Chile is followed by Uruguay and Colombia, which count with 1 560 and 772 operating companies

¹ BOST F., *The World of Free Zones - A Geographical Approach*, World Free Zones Economic Outlook, 2018, p.18

² MOCCIA J., *In the Zone: A look at Foreign Trade Zones in the U.S. and Canada*, Livingston International, 2016

³ ASOCIACIÓN DE ZONAS FRANCAS DE LAS AMÉRICAS, *Revista de zonas francas*, 2015, p.5

respectively. Puerto Rico and the Dominican Republic have 731 and 602 companies in their Free Zones. Finally, the countries with the least number of companies are El Salvador, Nicaragua and Paraguay.

Moreover, special economic zones are particularly widespread in Asia, where they are regarded as a key engine of the export-oriented growth in recent decades.

Examples of this kind could go ceaselessly. Therefore, in the next paragraphs some countries that deserve particular attention will be discussed.

4.2 USA

The first modern Foreign Trade Zone (FTZ) of the United States was established with the enactment of the Foreign Trade Zone Act of 1934 to offer special customs treatment to US factories. It was created during the period of the Great Depression and initially this FTZ provided exemption on duties when foreign merchandise entered into them.



Source: International Trade Administration, Department of Commerce

Since then, the concept of foreign trade zone has evolved significantly and nowadays there are approximately 4300 various types of zones worldwide, 293 of which are placed in the United States and are under the direct supervision of the US customs service.

Indeed, in an era of international competition and globalization, countries around the world are willing to attract foreign direct investment and seize the potential of these foreign trade zones.

While there is not a specific definition of what is a foreign trade zone, the term generally refers to «a specific and physical location within a country that has officially been qualified for tariff and tax exemption with respect to the purchase or importation of raw materials, components or finished goods, so that it is considered outside of the customs territory».

In the United States, foreign trade zones are secure areas under the supervision of the US Customs and Border Protection (CBP). Foreign and domestic merchandise may be moved into zones for operations, assembly, manufacturing, and processing. During its

stay in the FTZ, merchandise is not subject to duty or excise tax until the merchandise enters the United States territory for domestic consumption.

As a concept which is by and large native to this country, a foreign trade zone can also be defined as «the special geographic area located in or adjacent to US ports of entry wherein commercial merchandise can be handled without being subjected to customs duties and other *ad valorem* taxes».

In addition to storing, traders can also assemble, package, clean, test, repair or destroy their goods in these zones, without having to pay any tax for the same. This relief allows traders to low the cost of their operations in order to be more competitive on international trade, while creating job opportunities and capital investments in the country.

Without doubt, the tariff relief is only available for those goods which are restricted to these trade zones. Therefore, goods are treated in the same way as they would be treated outside the US territorial borders until they remain in the zone. If goods are meant to be imported and sold in the US market, they will be taxed as soon as they are moved out of these trade zones.

Generally, there are two types of foreign trade zones in the USA: the General-Purpose Zones and Special-Purpose Subzones.

General-Purpose Zones work as public utilities providing a variety of services to many users, especially small and medium enterprises. They are usually located in industrial parks or in seaport and airport complexes with facilities available for the general public. Special-Purpose Subzones, instead, are sites which provide the necessary support to the general-purpose zone and they are typically a part of a single company's operation used for their exclusive use⁴. Indeed, subzones often cover a single company's site used for more extensive manufacturing, warehousing or distribution that cannot be easily carried out in a general-purpose zone⁵.

Therefore, other than the 293 foreign trade zones, there also exist around 500 special purpose sub-zones in the USA. Even though each of these trade zones has some stipulations of their own, by and large all of them follow the same procedure.

⁴ MOCCIA J., *In the Zone: A look at Foreign Trade Zones in the U.S. and Canada*, Livingston International, 2016

⁵ ENGMAN M., ONODERA O., PINALI E., *Export Processing Zones: Past and Future Role in Trade and Development*, OECD Trade Policy Papers No. 53, 2007, p.13

In addition to the FTZ Act of 1934, foreign trade zones are also regulated by two sets of regulations: the FTZ Board regulations (Title 15 of CFR⁶, part 400) and CBP regulations (Title 19 of CFR, part 146). They are also affected by other laws and regulations at regional level.

The FTZ Act is the principal legal framework to take into consideration for the regulation of these zones. The Act has been codified in the United States Code (USC) as title 19 USC from paragraph 81a to paragraph 81u. The FTZ Act is periodically amended and covers the establishment and administration of zones and what may and may not be done in them.

FTZ Board regulations are those regulations which provide guidelines and procedures on the establishment and modification of zones, while CBP regulations are codified in title 19 of USC and the FTZ Act itself is a CBP law⁷. CBP laws are applicable to merchandise passing through the Customs territory before admission to, or after transfer from, zones. CBP laws are also applicable to prohibited merchandise in a zone, vessels and aircraft entering or leaving a FTZ, and merchandise which has been brought into a FTZ for purposes not specified in the FTZ Act.

Firms that operate in FTZs must consider also other Federal Laws. Since the FTZ Act specifically excludes only the application of CBP laws, most other federal laws are applicable in zones, such as those affecting public health, immigration, labour, welfare, and income tax. Various federal regulations may be applicable to FTZs⁸.

Generally, other state and local laws and regulations are applicable in zones, except if they are in contrast to federal laws or to the Constitution.

The creation of a foreign trade zone is a process that involves many steps.

The first step deals with the achievement of the geographic approval for a foreign trade zone site from the Foreign Trade Zones Board. Moreover, a business that is willing to operate within a foreign trade zone must gain the approval from the Foreign Trade Zones Board if production activity will take place at the zone site. Lastly, a business

⁶ The Code of Federal Regulations (CFR) is the code of the regulations issued by the Executive and the Federal Agencies of the United States of America and published in the Federal Register. It is currently divided into 50 titles covering all areas subject to US federal law.

⁷ US CUSTOMS AND BORDER PROTECTION, Office of Field Operations, *Foreign-Trade Zones Manual*, 2011, p.19

⁸ US CUSTOMS AND BORDER PROTECTION, Office of Field Operations, *Foreign-Trade Zones Manual*, 2011, p.20

wishing to use all or a portion of the foreign trade zone site must obtain also the approval of the CBP for activation to allow merchandise to be admitted in the zone.

The institutions that operate in FTZs are the FTZ Board, the Customs and Border Protection, and the Port Director.

The FTZ Board is responsible for the establishment, maintenance, and administration of zones under the FTZ Act. It can also deny or limit the use of zone procedures in specific cases on public interest grounds. The FTZ Board is made of the Secretary of Commerce, who is chairman and executive officer, and the Secretary of the Treasury⁹.

Instead, the CBP executes most of the duties and responsibilities of the Secretary of the Treasury, such as the putting in order and the implementation of the rules and regulations approved by the Secretary of the Treasury and the assignment of the necessary CBP personnel to perform zone related work¹⁰. The principal interest and matter of CBP regards also the control of the merchandise moving to and from the zone, the protection of the revenue, and to ensure that zone procedures conform to the FTZ Act and all laws and regulations concerning to zone use.

Lastly, the Port Director is the local representative of the FTZ Board. It is responsible for conducting general oversight of the zone, its processes and procedures and to report exceptions to the FTZ Board.

On the other hand the parties involved in the operations are the grantee, the operator, the user and the landowner.

The grantee gets the grant from the Foreign Trade Zones Board and is ultimately responsible for zone operations. The grantee is quite often a public entity, or a non-profit corporation established specifically to hold the grant.

The operator stipulates contracts with the grantee to run all or parts of the zone and is generally responsible for recordkeeping and dealing with Customs.

The user is the firm that owns the products in the zone and benefits from using zone procedures.

⁹ US CUSTOMS AND BORDER PROTECTION, Office of Field Operations, *Foreign-Trade Zones Manual*, 2011, p.21

¹⁰ US CUSTOMS AND BORDER PROTECTION, Office of Field Operations, *Foreign-Trade Zones Manual*, 2011, p.22

Lastly, the landowner is the person or institution that owns the property that has been designated as a foreign trade zone. In many cases, a single party may serve multiple functions¹¹.

The benefit which is common to all kinds of zones for companies located in them is the deferral of customs duties on imported merchandise. Imported merchandise is subject to duty when it comes into the US customs territory, which normally corresponds to the arrival of the merchandise in the United States. But as a zone is treated as to be outside the customs territory, merchandise that enters a zone is not dutiable until it leaves the zone and enters domestic commerce. As long as foreign goods remain in the zone, they remain free from duty.

Importers can also obtain a long-term cash flow savings advantage by “permanently” deferring the payment of duty for one inventory turn of merchandise held in a zone for as long as the zone remains operational.

As a consequence of the duty deferral rule, imported goods that are held in a zone and subsequently re-exported, either in its original form or as components of finished products produced in a zone, are not subject to a duty at all. Companies that import and re-export merchandise, receive this benefit.

This general rule has been adjusted only for those manufactured products exported from a US foreign trade zones to Canada and Mexico as part of the North American Free Trade Agreement (NAFTA) provisions endeavouring to harmonize customs treatment on duty remission programs. The article no. 303 of NAFTA, in fact, establishes that «a foreign component can be imported into a duty deferral program in a NAFTA country, such as a US foreign trade zone, for manufacturing into a finished product». If the finished product is then exported to another NAFTA member state, then the foreign component is subject to the US duty if the latter exceeds the duty charged on the completed product by the NAFTA trading partner. On the contrary, it is also possible to include a non-NAFTA component part into a NAFTA qualified finished good made in a zone, and re-export the latter to Mexico or Canada without paying any duty on the non-NAFTA component¹².

Another important benefit is the one regarding the inverted tariff. Like other developed nations, United States generally imposes higher tariffs on finished goods than on raw

¹¹ ERNST & YOUNG, LLP, *Foreign trade zone handbook*, 2013, p.15

¹² ERNST & YOUNG, LLP, *Foreign trade zone handbook*, 2013, p.3

materials or component parts. But, there are some exceptional cases in which the imported component of an item is dutiable at a higher rate than the one applicable to the completed item¹³.

In this case, when imported goods are admitted into a foreign trade zone, the importer is able to choose which of the two tariff rates, either the one on the component or the one on the finished good, will be applied to the goods by electing the status of the merchandise.

Goods can be classified as “privileged foreign merchandise” or as “non-privileged foreign merchandise”.

The former refers to the situation in which goods coming into the customs territory are subject to duties on the basis of their condition and quantity at the moment in which they are admitted into the zone. The duty is calculated using the value and rate established at the moment in which the merchandise was appointed as privileged foreign. If the merchandise is then exported no duties or taxes shall be paid.

The latter instead refers to the situation in which goods are dutiable at the rate that applies at the time when merchandise is transferred from the zone into the customs territory of the United States¹⁴.

Merchandise can obtain this status if it is:

- properly foreign merchandise in a zone that does not have been recognized as privileged or zone-restricted;
- waste obtained from any manipulation or manufacture of privileged foreign merchandise within a zone; or
- domestic merchandise in a zone that has lost its identity as such.

Indeed, any domestic merchandise is considered to have lost its identity if Customs determines that it cannot be identified positively as domestic merchandise on the basis of an examination of the merchandise.

On the basis of the two above mentioned categories, firms can avoid paying the inverted tariff by bringing high duty rate component parts into the zone on a non-privileged basis and then manufacturing or assembling those parts into a finished product subject to a lower duty rate.

¹³ BORDNER T., *The Benefits of Using a Foreign Trade Zone*, Inbound Logistics, 2014

¹⁴ TIEFENBRUN S., *Tax Free Trade Zones of the World and in the United States*, Edward Elgar Publishing, 2012, p.4

The merchandise located in a zone can assume other two statuses: “zone-restricted merchandise” and “domestic merchandise”.

The first status applies to merchandise that is brought into a zone for the purpose of exportation, destruction or storage. This kind of merchandise shall not be removed from the customs territory for domestic consumption unless the Foreign Trade Zones Board finds the return to be in the public interest.

The second status may be granted to merchandise:

- grown, produced or manufactured in the United States on which all internal revenue taxes, if applicable, have been paid;
- previously imported and on which duty and tax has been paid;
- previously entered free of duty and tax; or
- that has been substantially transformed within a foreign trade zone¹⁵.

Other benefits deal with the inadmissibility of goods and the quotas that may be applied in imports¹⁶.

In some cases, goods that do not respect import requirements may be brought into a foreign trade zone to correct the deficiency. For example, merchandise not properly labelled or packaged according to the US market prerequisites may be admitted to a zone and then relabelled or repacked in a foreign trade zone to conform to requirements of entry into domestic commerce¹⁷.

As goods in a zone are considered as to be outside of the customs territory, import quotas are generally not applicable to goods stored in foreign trade zones. For example, if an importer of product subject to a quota finds that he has obtained over-quota merchandise, he may store the merchandise in a foreign trade zone rather than re-exporting the merchandise, and subsequently bring the merchandise into domestic commerce of the United States during the next quota period¹⁸.

US foreign trade zones are achieving even more importance with the recent political facts. Indeed, the President of USA, Mr. Donald Trump, has increased the tariffs for some goods and raw materials imported from other countries¹⁹, such as aluminium and steel, to convince US companies keeping producing in the country rather than to move to less

¹⁵ ERNST & YOUNG, LLP, *Foreign trade zone handbook*, 2013, p.4

¹⁶ BORDNER T., *The Benefits of Using a Foreign Trade Zone*, Inbound Logistics, 2014

¹⁷ ERNST & YOUNG, LLP, *Foreign trade zone handbook*, 2013, p.6

¹⁸ ERNST & YOUNG, LLP, *Foreign trade zone handbook*, 2013, p.7

¹⁹ European Union, Mexico, Canada and China

developed countries to outsource their value chain. Therefore companies, especially those one whose products are based on the materials damaged by the rise of duties, are awakening to the idea of using trade zones to help mitigate the impact of tariffs.

Moreover, with the signature of the “Tax Cuts and Jobs Act”, Mr. Trump has reduced significantly the corporate tax for North American Corporations from 35% to 21%.

This strategy was intended to boost even more foreign trade zones and thank to this strategy they will become the best scenarios for the reshoring phenomenon that President Trump has himself promoted²⁰.

4.3 Central and South America

Central and South America comprises about 24 countries with more than 600 free trade zones. Each country has its own legislation but it is possible to find some similarities they have in common:

- lower income taxes;
- 0% Value Added Tax (VAT); and
- 0% on tariffs.

Other than the economic incentives offered by the Free Zones, there are also other attractive benefits:

- the security of operating in a free zone thanks to the various degrees of security needed to access the area;
- Free Zones are quick tools to position a product in the market thanks to the specialized and concentrated attention that companies will have. Each zone has administrators who are equipped to face the obstacles and challenges that a company may face and overcome so that it can enter the market as quickly as possible;
- Free Zones are communities made up of several partners and collaborators, who help to manage and see through the key steps of the process to start up their service or industry²¹.

In the region free trade zones can be classified into three as follows:

1. Export Free Zones with three identified models:

²⁰ IBARRA M.G., *United States' tax reform impact on free zones and special economic zones in the world*, World FZO Bulletin, 2018, p.5

²¹ DOSSANTOS R., *Las 3 cosas que no sabes de las Zonas Francas en América Latina*, Bizlatin Hub, 2017

- i) Industrial diversification: they are used to increase the added value of the products and services produced in the zone. For example, Costa Rica and Dominican Republic, in less than 10 years went from having a textile industry to count today with industries of high added value such as technology products, medical instruments and drugs.
 - ii) Dependents on the maquiladoras²²: they have been implemented in order to obtain advantages over CAFTA-DR²³ in countries such as El Salvador, Honduras, Guatemala and Nicaragua;
 - iii) Logistics services: they have been used exclusively for the distribution of goods and services to obtain logistics advantages in countries such as Chile, Argentina and Uruguay.
2. Free Zones of import substitution: these zones are located in Brazil and were implemented in order to obtain a greater supply of goods and foreign services in the domestic market.
3. Mixed Free Zones: this model consists in the use of three different types of free zones and operates in Colombia and Uruguay.
- i) Permanent: these Free Zones are those geographically delimited areas that have been specially designated by the government so that the companies that operate there are entitled to various incentives regarding taxes and tariffs.
 - ii) Special: these are areas in which the benefits of the free regime, in tax and tariff matters, are granted to a specific company as long as it meets the investment and employment requirements.
 - iii) Transitory: it is that area where the Government grants special authorization to host international fairs, exhibitions, congresses or

²² The maquiladoras are industrial establishments owned or controlled by foreign subjects, in which transformations or assemblies of components temporarily exported from more industrialized countries take place in a duty free and tax exempt regime. The assembled or transformed products must subsequently be exported abroad. This phenomenon is characteristic of Mexico in those cities near the border with the United States.

²³ The Dominican Republic–Central America Free Trade Agreement (CAFTA-DR) is a free trade agreement. Originally, the agreement encompassed the United States and the Central American countries of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua, and was called CAFTA. In 2004, the Dominican Republic joined the negotiations, and the agreement was renamed CAFTA-DR. The CAFTA-DR constitutes the first free trade agreement between the United States and a small group of developing countries.

seminars that are important for the national economy and international trade²⁴.

4.3.1 Mexico

In Mexico is possible to find two types of zones: foreign trade zones and special economic zones. These are disciplined by the Federal Law on Special Economic Zones of 2016 and by the article no. 135-B of the Customs Law (Foreign Trade Zones).

The former defines SEZs as «geographical areas of the national territory, determined in unitary form or by sections, subject to the special regime foreseen in this Law, in which can be carried out activities of manufacturing, agroindustry, processing, transformation and storage of raw materials and supplies without limitation; innovation and scientific and technological development; the provision of support services for such activities as logistic, financial, computer, professional, technical and other services deemed necessary for the purposes of this order, as well as the introduction of goods for such purposes»²⁵. The latter instead defines foreign trade zones as «a regime which consists of the introduction, for a limited time, of foreign, national or nationalized goods, into the strategic controlled enclosures, to be handled, stored, sold, distributed, transformed or repaired».

Companies operating in these zone benefit from the total exemption on income tax for the first 10 years and then from the 50% reduction on income tax for the next five years. Moreover 0% value-added tax and 0% tariff are applied when companies acquire goods for use in the SEZs. Goods imported to Mexico to be used exclusively in the SEZs are not treated as imports. In addition, Investors may apply an additional 25% tax allowance equivalent to the expense regarding employees training²⁶.

Recently, the Mexican Federal Government published many decrees to create some more special economic zones «to promote sustainable economic growth that, among other purposes, reduces poverty, allows the provision of basic services and expands

Figure 2: Free zones of Mexico



Source: La Zonas Francas del siglo XXI, Revista AZFA

²⁴ ASOCIACIÓN DE ZONAS FRANCAS DE LAS AMÉRICAS, *Revista de zonas francas*, 2017, p.5

²⁵ Article no. 3, Ley federal de zonas económicas especiales

²⁶ AZFA, *La Zonas Francas del siglo XXI*, 2017, p.22

opportunities for healthy and productive lives, in the regions of the country that have the greatest lags in social development, through the promotion of investment, productivity, competitiveness, employment and a better distribution of income among the population»²⁷. These will be located primarily in the southeast of the country as they are generally underdeveloped from an industrial perspective compared to the rest of Mexico.

4.3.2 Cuba

Cuba has recently established its first Special Development Zone with the Official Journal no. 026 of 23rd September 2013 and no. 23 of 7th May 2014. In ZED Mariel there are 26 companies under operation from 16 countries and 5 multinationals.

Companies benefit from the total exemption on income tax for the first 10 years and onwards the rate will be 12%. No tariffs are applied and as regards VAT, for the first year it is equal to 0% and later it will be equal to 1%²⁸.

Figure 3: The SDZ of Cuba



Source: La Zonas Francas del siglo XXI, Revista AZFA

4.3.3 Dominican Republic

The Dominican Republic is one of the countries with the largest number of free zones. The country has 212 FTZs, 68 Industrial and Service FTZs and 144 Special FTZs. These are disciplined by the Law no. 8 of 1990 on the Development of Free Zones and by the Law no. 4315 of 1955.

The benefits generated by the Free Trade Zones to the local economy are five times greater than the exemptions granted by the Government²⁹.

Companies operating in these zones can benefit from 0% on income tax, tariffs and VAT. In addition, there is a 100% exemption on municipal taxes, asset and equity tax, construction

Figure 4: Free zones of the Dominican Republic



Source: La Zonas Francas del siglo XXI, Revista AZFA

²⁷ Article no. 1, Ley federal de zonas económicas especiales
²⁸ AZFA, *La Zonas Francas del siglo XXI*, 2017, p.9
²⁹ AZFA, *La Zonas Francas del siglo XXI*, 2017, p.32

tax and over loan contracts³⁰.

4.3.4 Panama

In Panama there are three legislations for Economic Zones; one for Colón Free Zone, another one for Panama Pacífico Special Economic Zone and another one for the remaining Free Trade Zones.

The Colón Free Zone was established in 1948 and is the second largest free trade zone in the world. It was established with the Decree Law no. 18 of 17th June 1948 and it is disciplined by the Law no. 29 of 1992 adopting the Special System of Colón Puerto Libre substituted by the Law no. 8 of 2016 that reorganizes the zone.

The Panama Pacífico SEZ was created under the Law no. 41 of 20th July 2004 as a project intended to transform a former U.S. Air Force base into a special economic zone for international trade, commerce, and industry and to develop the site as a commercial, residential, logistics and business hub³¹.

The other free zones were established in 2011 under the Law no. 32 in an effort to broaden the Panamanian economic development.

All the zones offer as incentives 0% on income tax, VAT and tariffs. A peculiarity of the Colon Free Zone is that dividends that come from external operations or from those executed abroad are subject to 5% as dividend tax, as established by Law no. 8 of 2010. As a matter of fact, this Law establishes that «legal entities or companies established or that will establish in the Colon Free Zone or in any other zone or free area established or that is created in the future are obliged to withhold the dividend tax or participation fee of five percent of the profits distributed to its shareholders or partners when they are from:

- Panamanian source or internal or local operations;
- Foreign source or foreign or export operations; and
- Income exempt from income tax, provided in literals f, l and n of article no. 708 of the Customs Code".

Figure 5: Free zones in Panama



Source: La Zonas Francas del siglo XXI, Revista AZFA

³⁰ AZFA, *La Zonas Francas del siglo XXI*, 2017, p.32

³¹ WORLD BANK, *Panama - Pacifico Special Economic Zone (SEZ)*. Public-Private Partnerships briefs. Washington, D.C., 2013, p.1

4.3.5 Colombia

The country has 111 FTZs: 42 are Permanent FTZ³² and 69 are Single Company FTZs³³. Indeed, Colombia is the first country with the greatest number of free trade zones in South America. Moreover, there are some transitory FTZ where fairs, exhibitions, congresses and seminars of national and international character are held, which are important for the economy and international trade³⁴.

Unlike other countries in the region, Colombia has a model named special permanent free zones, commonly known as business units, where a legal person or a single company is granted the status of Free Trade Zone in any part of the country, so they can perform industrial activities of services in a certain area if the investment generates a high social and economic impact. This impact is measured by the amount of investment and jobs created³⁵.

These zones are disciplined by the Law no. 1004 of 2005, by the Decree no. 1289 of 2015³⁶ and by the Decree no. 2147 of 2016 that has been modified by the Decree no. 659 of 2018.

Companies operating in Colombian free zones can benefit from an income tax of 20% against the 33% applied in the national territory. Companies are exempted from surcharge over income tax, dividend tax, tariffs and VAT. Moreover, users have the possibility of doing partial processes outside of the FTZ up to 9 months³⁷.

Figure 6: Free zone in Colombia



Source: La Zonas Francas del siglo XXI, Revista AZFA

³² Zones where multiple industrial or commercial users are settled in, which enjoy tax, customs and foreign trade treatment.

³³ Zone in which a single Industrial user is settled in, which enjoys special tax, customs and foreign trade treatment.

³⁴ Article no. 3, Decree no. 2147 of 2016

³⁵ ABUSAID GÓMEZ & ASOCIADOS, *Comparison between Colombian and Latin-American Free Trade Zones*, 2017

³⁶ Assigns to the Ministry of Commerce, Industry and Tourism the administration of promotion and investment instruments as free zones

³⁷ AZFA, *La Zonas Francas del siglo XXI*, 2017, p.13

4.3.6 Brazil

The country has one Industrial Free Trade Zone and many Export Processing Zones. Currently, Brazil has authorized 25 EPZ from which 19 are under development.

The free trade zone of Manaus was established in 1967 with the Law Decree no. 288/67.

Article no. 1 states that « the Free Trade Zone of Manaus is a free trade area for import and export and special tax incentives, established with the purpose of creating in the interior of the Amazon an industrial, commercial and agricultural center with economic conditions that allow its development, in the face of local factors and the great distance that the consumer centers of their products can find. It also sets forth that the sale of domestic goods to the FTZM for consumption or manufacturing processes must be equal to foreign trade transactions, for tax purposes. It is important to underline that in general, exports from Brazil are exempt from taxes. Recently, the Brazil's Superior Court of Justice, which has the power to deliver final decisions regarding legality, has reaffirmed this rule³⁸.

The first export processing zone was set up in 2007 with the Law no. 11508 of 20th July 2007 with the purpose of reducing regional imbalances, as well as strengthening the balance of payments and promoting the diffusion technological and economic development of the country³⁹.

The Law establishes also limits and requirement:

- the industrial projects established in Brazilian EPZ must be greenfield investments;
- companies should obtain at least 80% of the company's total gross revenue sales originated by exports. Products sold to the domestic market will be subject to the payment of all taxes normally granted by the EPZ regime;
- the tax suspension is limited to the acquisition of capital goods, raw materials, intermediate products and packaging materials;

Figure 7: Free zone of Brazil



Source: La Zonas Francas del siglo XXI. Revista AZFA

³⁸ DA SILVEIRA R.M.D., COELHO R.G., *Brazil affirms tax benefit for sales to the free trade zone of Manaus*, International Tax Review, 2019

³⁹ Article no. 1, Law 11508 of 20th July 2007

- Companies installed within an EPZ cannot establish a branch or subsidiary neither participate in another legal entity located outside the Export Processing Zone.

Both the types of zones offer the reduction up to 75% of the income tax, 0% tax over industrialized goods, the reduction of 88% of tariffs over raw materials used for industrialization, the reduction between 55% and 100% of the tax over movement on goods and services and long term legal stability contracts for 20 years extendable for 20 more years⁴⁰.

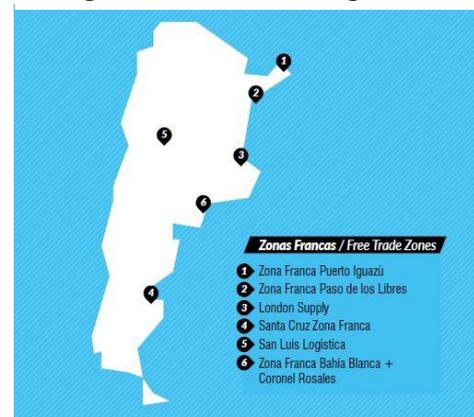
4.3.7 Argentina

Argentina has established free zone since 1994 where warehousing, commercial, service and industrial activities, with the sole purpose of exporting the resulting merchandise to third countries, can be developed. These zones are disciplined by the Law no. 24331 and by the Customs code from the article no. 590 which defines these areas as «an area within which the merchandise is not subject to the customary control of the customs service and its introduction and extraction are not taxed with the payment of taxes, except for the remuneration rates of services that could be established, nor reached by prohibitions of an economic nature».

According to the article no.4 of the aforementioned law «Free Trade Zones have the objective of boosting trade and industrial export activity and of facilitating the increase in efficiency and the reduction of costs associated with the activities carried out in them that will be extended to investment and employment. The functioning of the free zones shall be convergent with the national commercial policy, and should contribute to the growth and competitiveness of the economy and be fully incorporated into the regional integration process».

The merchandise coming into free zones benefits from tariff exemption and 0% VAT on finished goods in addition to a 100% exemption of the VAT over raw materials

Figure 8: Free Zones of Argentina



Source: La Zonas Francas del siglo XXI, Revista AZFA

⁴⁰ AZFA, *La Zonas Francas del siglo XXI*, 2017, p.11

purchased within the national territory. Moreover, Exports from FTZs benefit from the provisions established in Free Trade Agreements stipulated with other countries. A peculiarity of this country is that it does not provide any exemption from the corporate tax in free zones which is established at 35%⁴¹.

4.4 Asia

Like in other countries, also in Asia free zones are considered as outside of the customs territory. Their establishment aims at attracting foreign direct investments and at providing a business friendly environment with incentives, good infrastructure and other advantages.

Most of all, free zones have concentrated traditionally on manufacturing for export, and many of them are located along the coast or near sea transport routes to leverage international transportation.

Asian free zones have some differences with respect to other free zones in the world because of differences in political, economic and social situations.

For example, the whole territory of Singapore is a free zone, while almost all other countries, such as the Republic of Korea and Malaysia, have established very specific and small areas as free zones compared to the size of the whole country.

The situation in China is different from the other countries. Since China opened its economy to the world in 1980s, the country has introduced many types of special zones of various sizes covering from large to relatively small areas.

Moreover, China's economic activities are taking place mainly through these various special zones, unlike most other countries.

By taking into account these few examples of the Asian region, it is possible to identify three types of zones based on the extent of the FTZ's role in the whole economy, that it is to say the country or market size, the economy, political and social situations. However, these types of zones are not necessarily standard classifications of FTZs nor do they necessarily represent desirable policy directions.

4.4.1 China

The strong growth of China in the last 30 years is the result of careful economic policies that the government has outlined with punctual strategies in every aspect. Part of these

⁴¹ AZFA, *La Zonas Francas del siglo XXI*, 2017, p.8

policies regards the creation of special economic zones useful for attracting foreign capital through tax, economic and logistical facilities. Such areas are usually set up in port cities, in industrial areas or in regions where particularly active technological or manufacturing poles have been created.

The zone program started with Special Economic Zones in geographical areas in which the laws in force that regulated economic matters were characterized by less rigidity than in the rest of China, giving rise to greater advantages for the companies that operated there. In these areas, generally located near the borders or major international ports and airports, goods can be unloaded, processed and re-exported

Figure 9: Special economic zones in China



Source: Google

without any interference from the country's customs authorities; only in the event that these goods leave the Special Economic Zone to enter the Chinese market will they be subject to normal customs rules. The companies that operate there enjoy significant tax benefits such as tax exemptions for manufacturing and export firms. SEZs also allow companies that fail to make a profit to not pay taxes; after a company becomes profitable, it can pay reduced taxes for the next five years.

The first five special areas were established in the cities of Shenzhen, Zhuhai, Shantou, Xiamen and in the entire province of Hainan.

After being successful, the zone program and relevant reforms were gradually launched throughout the nation in more diversified forms, and some of the zones were designed with more sophisticated agenda, such as the high-tech industrial parks smaller than the earlier zones⁴².

These new areas were defined as Free Trade Zones which are identified areas where the State grants both financial and non-financial incentives and a general streamlining of the bureaucratic system to attract foreign companies to invest in them.

A further type of area is represented by the Export Processing Zones typically near the areas of economic and technological development. Still remaining Free Trade Zones,

⁴² ZENG D.Z., *Global Experiences with Special Economic Zones: Focus on China and Africa*, The World Bank: Washington D.C., 2015, p.3

these areas require specific conditions, such as that the goods in transit undergo processing before being exported again.

Despite the different nomenclature of the zones, and the specific conditions required to obtain the benefits, all these types are united by tax benefits such as exemption from customs duties and indirect taxes on imports of specific types of products, possibility of preserving raw materials or components and packaging materials imported into customs warehouses, exemption from duties or export taxes when products modified in the special area are exported outside the territory of the People's Republic.

Another category is represented by the Bounded Zones or Logistics Parks which are a particular type of EPZ, attributable to the category of "Industrial Free Zones". These were originally configured as the fate of enclaves, located near the major Chinese cities and intended to promote the country's international trade: this goal had to be achieved by building warehouses in which to store and exhibit goods and thus allowing access to the capital and equipment of foreign companies without them having to pay duties or other taxes. Adapting particularly to the direct exchange of products, these special areas have assumed the role of logistic pole of the main multinational companies, consisting in the storage of goods in free zones, in simple transformation and in the distribution of goods. Incentives to companies operating in Bounded Zones generally consist of tax credits and facilitated rates, exemption from duties and taxes for import-export transactions and VAT reductions on products. One of the most important Bounded Zones in China is the Shanghai Free Trade Zone, which was the first free trade zone established in China in 2013. The economic operations that take place there range from international trade to export processing, logistics and goods transfer. The advantages are numerous, from the free entry of goods imported from other foreign markets, with exemption from payment of VAT and customs duties, the possibility of completing the goods or their storage and display without any time limit, the ability to trade within the area or to sell goods to foreign markets without having to pay VAT or customs duties, the absence of taxes of any kind with regard to the equipment, materials and machinery used by the companies located within the Bounded Zone, in the fact that any economic and trading activity carried out within the area is presumably considered export, with the application of the relative benefits⁴³.

⁴³ RICCARDI L., *Le Zone speciali in Cina, tra Free Trade Zone (FTZ) ed Export Processing Zones (EPZ)*, Corriere Asia, 2014

For these reasons free zones are very important tools both for China and for companies that either wish to operate in China, or wish to enter the Chinese market. Indeed, the Chinese government is focusing hard to further establish and expand current FTZs and importers take advantage as it is a method of avoiding dealing with complicated import regulations and processes of the country.

The most important zones today are Shenzhen, which was a small fishing village that grew out to be one the most innovative cities in the world, Shanghai, Hong Kong and Hainan.

As regards legislation, China has acquired legislative experiences from foreign countries and applied those experiences in making FTZ rules.

However, China has its own social and legal characteristics. Therefore, the country decided to formulate and perfect the FTZ regulatory framework by an incremental approach, rather than enact a comprehensive FTZ legislation at the outset.

Although China does not have a designated legislation for FTZs, there are administrative regulations for the zones⁴⁴. For example, there are the “Regulations of Shenzhen Special Economic Zone on Business” of 1999 and revised in 2004, the “Regulations on Special Economic Zones in Guangdong Province” of 1980, the “Regulations of China (Shanghai) Pilot Free Trade Zone” of 2014 and the “Regulations of Hainan Special Economic Zone against unfair competition” of 1993.

Also the Customs Code of 1987 must be taken into consideration, especially article no. 40 which explicitly refers to special economic zones.

4.4.2 Japan

The concept of ZES as a way to propose and test structural reforms was born with the Koizumi government in the early 2000s.

Since 2003, more than 1000 projects have been approved and around 400 special economic zones have been created in Japan, but even in the best cases they have had a very marginal effect: in truth, the majority has not led to any change.

The first experiment involved the opening of the agricultural sector to private companies in 2003, which could lease the land from farmers in some areas of Niigata prefecture.

⁴⁴ PENG D., FEI X., *China's Free Trade Zones: Regulatory Innovation, Legal Assessment and Economic Implication*, The Chinese Economy, 2017, p.241

By 2013, a lot of companies had taken advantage of deregulation, making the project one of the most successful according to common opinion. However, at national level the effect was very low. The reasons for the bankruptcy are to be found mainly in the fact that companies were not allowed to buy land, but they were required to return them at the discretion of the custodian. Another attempt to reform referred to the increase in the volume of naval cargoes managed in the ports through the easing of customs and port regulations in the city of Kitakyushu. Also this attempt failed as the total increase of volume was very low.

Figure 10: Special zones in Japan



Source: Google

Later, in 2011, the Democratic Party tried again with the comprehensive special zones of which there are two types⁴⁵: the international strategy comprehensive zones, which favour the aggregation of industries in the environmental technology and logistics sectors to improve the international competitiveness of Japan, and the local revitalization comprehensive zones to support entrepreneurial initiatives in tourism, ecology and related sectors⁴⁶. The key points of the projects were greater attention to the environment, the creation of new commercial ports, the use of biotechnologies also outside the agricultural sphere, the creation of bases for doing business in Asia, the increase in the number of international tourists and the improvement of the transport sector.

However, the program ended up turning into a series of bribes for 2 billion yen granted to some zones in the form of government subsidies, causing strong competition between the areas to get subsidies⁴⁷.

A third attempt was made by Prime Minister Abe. The "Japan Revitalization Strategy" plan, issued on 14th June 2013, contains the first official reference to the need to establish special economic zones. Their creation was then recalled in the formulation of the Law on Strategic National Special Zones of 7th December 2013⁴⁸. Subsequently, on 25th February 2014, the Abe Government approved the Basic Policies for National

⁴⁵ MATSUO Y., YAMAZAKI J., *Japan's special zone scheme: Third time lucky?*, Nikkei Asian Review, 2014
⁴⁶ IPB Inc., *Japan Special Economic Zones Handbook - Strategic Information and Regulations*, 2016, p.48
⁴⁷ MATSUO Y., YAMAZAKI J., *Japan's special zone scheme: Third time lucky?*, Nikkei Asian Review, 2014
⁴⁸ Act no. 107 of 13th December 2013

Strategic Special Zones and designated the six strategic areas the first May of the same year⁴⁹. Today, the most important special zones are Ota, Tsukuba and Fukuoka⁵⁰.

Beyond the differences in the legal systems of the individual areas, there are nevertheless a series of tax incentives and guaranteed tax reductions for all investors in each area. In particular, a deduction of up to 50% of the costs for the purchase of machinery or equipment necessary for research and development activities and a deduction of 25% for the purchase of facilities and warehouses; companies in the medical sector engaged in research may have special incentives that reach up to 100% of the cost of the machinery. In the three years following the start of a business, the taxable base for assets acquired at the start of the business is 50%, while the remaining 50% falls within a special depreciation⁵¹.

4.4.3 Singapore

FTZs in Singapore were first established in 1969 with the Singapore Free Trade Zones Act, last revised on 2014, to facilitate entrepôt trade in dutiable goods.

In these zones, goods can be stored without providing any customs documentation until they are released in the market. They can also be processed and re-exported with minimum customs formalities. Moreover, duty and Goods and Services Tax (GST) on cargo within the FTZs are suspended, and are only payable when the goods leave the FTZ and enter customs territory for local distribution⁵².

FTZs in Singapore are primarily for transshipment cargoes, and the key characteristic of Singapore is that the whole country is similar to FTZs. This means that in examining the concept of an FTZ with reference to Singapore, the whole country system needs to be considered⁵³. Indeed, the country is considered a tax heaven thanks to its low tax rates and to the many incentives it provides to foreign investors. Among these, no taxation on capital gains, no taxation on earned interests and no taxation on overseas income deserve to be mentioned.

Figure 11: Free Trade Zones of Singapore



Source: Singapore Customs

⁴⁹ MINISTRY OF FOREIGN AFFAIRS OF JAPAN, *Japan Revitalization Strategy*, 2014, p.18
⁵⁰ IPB Inc., *Japan Special Economic Zones Handbook - Strategic Information and Regulations*, 2016, p.47
⁵¹ PWC JAPAN TAX, *Tax Incentives for National Strategic Special Zones*, 2014, p.2
⁵² SINGAPORE CUSTOMS, *Keeping Singapore's Free Trade Zones in check*, in SYNC, no. 45, 2017, p.2
⁵³ UNESCAP, *Free Trade Zone and Port Hinterland Development*, United Nations publication, 2005, p.47

4.4.4 South Korea

The first special zones established in South Korea were Masan and Iksan Export Processing Zones in 1970 and 1973 respectively. These were intended as non-tariff zones with incentives such as preferential tariffs and taxes to attract foreign direct investment to promote export, employment and technology transfer⁵⁴. These zone were designated by mayors and provincial governors authorized by the Foreign Investment Promotion Act.

The major incentives were the tax reduction and exemption on the national tax of 100% for the first 3 years and of 50% for the following 2 years, and on local tax which was reduced or exempted up to 15 years⁵⁵.

In the early 2000s the name of export processing zone was changed to free trade zone. These new zones were designated by the Minister of Trade, Industry & Energy with the Act on the Designation & Management of Free Trade Zones.

The new major incentives were the tax reduction and exemption on the national tax equal to the foreign investment ratio for the first 3 years and 50% of the ratio for the following 2 years, and the exemption on local tax for 15 years⁵⁶.

In 2002 the Korean government declared Busan and Gwangyang ports as customs free zones, and then Incheon Port and Incheon International Airport⁵⁷ in 2003 to promote the international logistics industry.

Initially, some differences between free trade zones, the former export processing zones, and customs free zones could be noticed.

Free trade zones were intended as manufacturing-oriented special zones while customs free zones were intended as logistics-related zones where manufacturing was not allowed. However, in 2003 the two concepts of zones were combined into free economic zones by the Special Act on the Designation & Management of Free Economic Zones. The

Figure 12: Free economic zones of South Korea



Source: fez.go.kr

⁵⁴ UNESCAP, *Free Trade Zone and Port Hinterland Development*, United Nations publication, 2005, p.68

⁵⁵ MONGOLIAN NATIONAL CHAMBER OF COMMERCE AND INDUSTRY, *Free Trade Zone and Free Economic Zone of Korea*, 2017

⁵⁶ MONGOLIAN NATIONAL CHAMBER OF COMMERCE AND INDUSTRY, *Free Trade Zone and Free Economic Zone of Korea*, 2017

⁵⁷ It was designated as the first Economic Zone to focus on attracting more foreign direct investment and revitalizing the national economy

result was that both manufacturing and logistics activities were allowed within the zones⁵⁸.

Even if a definition of free economic zone is provided by article no. 2 of the Free Economic Zone Law, each free zone has defined it in its own way.

According to the FEZ Act, industrial complexes, adjacent hinterlands of airports and seaports, distribution complexes or freight terminal could be the areas which can be selected as FEZs.

The main goals of this tool are clearly defined by the Free Economic Zone Planning Office of South Korea. Among these, attracting domestic and foreign capital, expansion of international trade, integration into the global economy, increasing high-tech industry, development of export-oriented industries and the transformation of Economic Zones into a logistics and business hub deserved to be mentioned.

Domestic and foreign companies that set up operations in FEZs will benefit from many advantages provided by the FEZ Act, the Restriction of Special Taxation Act and the Enforcement Decree of the previous Act.

Foreign companies in particular will be provided with preferential treatment in terms of taxes and leasing fees⁵⁹.

Companies will be exempted from the payment of corporate and income taxes and from acquisition and property taxes for the first three years and then they will benefit from a discount of 50% for the following two years if:

- more than USD 10 million in the case of foreign manufacturing company or more than USD 5 million in the case of foreign logistics company⁶⁰ is invested⁶¹;
- the amount of foreigners' investment is USD 30 million or more; or
- the foreign investment ratio is 50/100 or more, and the gross development costs for the relevant free economic zone are USD 500 million or more⁶².

Moreover, customs tax on foreign goods brought into the FTZ by companies operating in the zones will be exempted. No value added tax on local goods brought into the FTZ by

⁵⁸ UNESCAP, *Free Trade Zone and Port Hinterland Development*, United Nations publication, 2005, p.68

⁵⁹ LEE Y., *International development and free economic zone: The case of the Incheon Free Economic Zone in South Korea*, 2011, p.15

⁶⁰ Foreign company is defined as the one a foreign entity owns more than 10 per cent of total shares of the company according to the relevant law.

⁶¹ Article 116-2 (5) 2, Enforcement Decree of the Restriction of Special Taxation Act

⁶² Article 116-2 (5) 2, Enforcement Decree of the Restriction of Special Taxation Act

companies operating in the zone, or on business transactions between companies operating in the zone will be imposed⁶³.

A peculiarity of FEZs is that these tools provide international schools for education and hospitals, hotels and residential areas for foreigners in addition to infrastructures such as manufacturing related facilities and international logistics facilities.

Indeed, the government allows the establishment of hospitals, medical and education institutions and broadcasting stations by foreigners which are not allowed outside of FEZs.

⁶³ UNESCAP, *Free Trade Zone and Port Hinterland Development*, United Nations publication, 2005, p.70

CHAPTER V

5.1 Comparison among the different legislations

There have been profound changes in the Economic Zone concept and development approach since the first modern zone was established in Ireland in 1959.

The reasons for the development of special economic zones is different for developing and developed countries. In developing countries, the government typically grants import and export duty exemptions, streamlined customs and administrative controls and procedures, liberal foreign exchange policies, and income tax incentives, all designed to boost an investment's competitiveness and reduce business costs. Zones in developing countries support wider economic reform strategies, are needed to alleviate growing unemployment, act as experimental laboratories for new policies and approaches to business, and attract foreign direct investment. This infrastructure rationale is one of the most important driving forces behind zone establishment in less develop countries.

Instead, the rationale for developed countries is more varied. The new economic zone program in South Korea, for example, is explicitly intended to promote foreign investment. The main rationale for the Shannon Free Zone in Ireland, in contrast, was to establish a growth pole in the economically distressed southern part of the country. Revitalization of economically distressed urban and rural areas is the motivation behind the many enterprise zones of United States. But overall, enhancing trade efficiency and manufacturing competitiveness remains the principal rationale for most developed countries¹.

Nevertheless, all zones operate under the same simple principles:

- allowing investors to import and export free of duties and exchange controls;
- facilitating licencing and other regulatory processes; and
- usually freeing these firms from obligations to pay corporate taxes, VAT, or other local taxes².

Even if free zones in the EU are regulated only by the Community Customs Code, the European legislation is quite restrictive because Member states have to take into account laws about state aids. Indeed, reductions and exemption which can constitute

¹ LEE Y., *International development and free economic zone: The case of the Incheon Free Economic Zone in South Korea*, 2011, p.29-30

² FAROLE T., *Special economic zones: What have we learned?*, Voxeu, 2011

state aid must be approved by the European Commission before they are guaranteed to established companies. Moreover, companies may have to respect some requirements that vary according to the country and the zone. For example, companies must invest a minimum amount of money in assets or must create a minimum number of jobs.

Nevertheless, an advantage (or disadvantage, according to the different points of view) of the European Union is that Member states can freely create free zones where they believe it is necessary and any company can decide to establish itself in them.

As regards United States, instead, there are many Acts and Regulations to be respected due to the hierarchy of regulatory sources, in fact there are federal, state and local laws. Moreover, the creation of this kind of tools is not easy as in Europe, but it must overcome many steps. An important peculiarity of US free zone regards the inverted tariff, that is the company can choose which tariff rate should be applied according to the merchandise status.

Free zone of Central and South America, like the other free zone worldwide, offer the same benefits. In all countries, free zone are regulated by laws and decrees specifically created. The difference lies in the fact that each country grants different rates of tax reliefs. Unlike other countries, the legislation of these countries is not so restrictive because their aim is to attract the largest number of companies to attract investments and improve the quality of life and the economy of the country.

Focusing on Asia, almost all countries have issued laws especially created for the regulation of zones except from China that decided to formulate and perfect the FTZ regulatory framework by an incremental approach, rather than enact a comprehensive FTZ legislation at the outset so that the country does not have a designated legislation.

Among all Asian countries, South Korea is the country which has established many requirements for companies that want to benefit from fiscal incentives.

5.2 Successful and failed free zones

To date, many free zones of all types and forms have been created but not all of them have been able to get going and succeed. In fact, many governments have failed to create functioning free zones.

The most successful zones are connected with the domestic economy: South Korea, for example, has been good at fostering links with local suppliers. Zones need to be connected to global markets. Improving infrastructure for this purpose has a bigger

impact on the success of zones than tax breaks do. This often requires public spending to upgrade roads, railways and ports to handle the extra freight³.

A striking example of success concerns the city of Shenzhen which has been able to create what economists call "backward and forward linkages" with the domestic economy, that is, it has been able to connect foreign investors who benefited from tax incentives with Chinese companies offering goods and services. In this way, the free zone has not remained an isolated free port but has been able to integrate with the national economy contributing to the increase in technology transfer and skills development⁴.

This was possible because the country was able to invest in a local network of entrepreneurs and encourage the growth of small and medium-sized companies so that they would become the main suppliers of the largest foreign companies⁵.

But not only this, also other factors have contributed to the success of the city that has turned from a small fishing village into one of the fastest growing cities in China and the world. These include:

- the fact that the free zone of Shenzhen was considered as a pilot project to evaluate the effects it would produce and then extend them to the rest of the country; and
- the fact that at the time the free zone was established, the Chinese government had already provided for a long-term plan also supported by the condition of stability of the country⁶.

The basic concept that China purposed in creating its first special economic zones was an open and liberal policy environment. It becomes the most important reason behind Shenzhen's success⁷.

Another successful example is the colon free zone in Panama. In this case, one of the key elements that contributed to his statement was the position as Panama gives access to the Atlantic Ocean and the Pacific Ocean. This meant that it became the hub of exchanges with the American and the Asian continent in an era of globalization of the world economy. In addition, the government continuously allocates funds for the restructuring

³ THE ECONOMIST, *Special Economic Zones: Not so special*, The Economist Group Limited, 2015

⁴ ASIAN DEVELOPMENT BANK, *A New Look at Special Economic Zones in Asia*, Adb.org, 2015

⁵ SCHNEIDER G., *Special Economic Zones: Where Russia is getting it wrong*, Russia Direct, 2016

⁶ NORMAN M., *Have 'Special Economic Zones' Entered the 21st Century Yet? A Tale of Two Cities*, Worldbank.org, 2014

⁷ SARI et al., *The Role of Special Economic Zones in China Economy Development*, 2012, p.19

and modernization of infrastructure to offer its customers cutting-edge technology and the best services in addition to competitive prices.

Among the various successes, the Dominican Republic also deserves to be mentioned, which has been able to create a sizeable manufacturing sector, thus making the country no longer dependent on agriculture⁸.

In addition to these examples, there are other areas of success many of which are mostly the result of experiments of openness to free trade in territories that are reluctant to launch liberal economic reforms.

The success factors that characterized the main free zone experiences were different, and among these a significant role was played by the low cost of energy, the low cost of labour, the spatial characteristics of the place and the strategic location of the areas, which facilitated trade flows with other countries.

Although each area has been successful for several reasons, it is still possible to find common elements that it would be useful to keep in mind.

In general, 5 elements can be defined:

- all free zones have been created for a specific reason, such as the creation of jobs in places with a high rate of unemployment, as happened in developing countries, the promotion of exports, the development of certain industrial sectors, the attraction of foreign capitals or for technology transfer;
- all countries have formulated new policies or have liberalized existing legislation, for example by reducing taxes, exempting from or reducing the payment of import tariffs, simplifying customs procedures for goods imported into free zones and liberalizing labour policies also to attract workers from abroad;
- all states have taken into consideration the location, in fact many free zones are located near ports and airports in which companies can find local infrastructures that easily give access to gateways to the market or areas where it is possible to find an educated and specialized workforce;
- the design of the SEZ was made carefully to compensate for what the location lacks, to cater to what the investors desire, to address the government's concerns and to integrate with the surrounding area; and

⁸ FAROLE T., *Special economic zones: What have we learned?*, Voxeu, 2011

- all areas have an efficient and effective management that knows how to maintain the initial vision but at the same time knows how to be flexible to changes thanks to public-private partnerships⁹.

A free zone, to be successful in the long term, must contribute to a structural change in the economy that includes diversification and improvement.

This includes investment by domestic firms into the zones, forward and backward linkages, efficient infrastructures, business support, and the seamless movement of skilled labour and entrepreneurs between the zones and the domestic economy¹⁰.

Moreover, the planning of a zone should be integrated into a long-term national development strategy in order to receive support from the government which should provide a strong legal and regulatory framework and institutions¹¹.

To summarise, the key elements that affect the success of a zone, and therefore deserve special attention, are the location, the infrastructure, the government stability, laws and regulations skilled labour, efficient services, logistics and finally the synergy between the zones and the host country¹².

Each medal, however, has two sides, so for every success there is also a failure.

An example are the Nigerian zones. The first area was established in 1992 and put into operation in 2001 but it was unable to attract significant investments or create a vast amount of jobs. The causes of this failure are due to various reasons:

- the government failed to choose a location that had a solid business case; although the city chosen was located near the sea, this was not connected to any shipping route nor to an important highway;
- the port and the free zone have never been merged; in fact, being the port under the control of the Ministry of Transport while the area under the management of the competent authority, the two parties have not been able to exploit the synergies between the port and the free zone;

⁹ CHEONG T.E., *The Key Success Factors of Special Economic Zones*, Surbana Jurong, 2018

¹⁰ FAROLE T., *Special economic zones: What have we learned?*, Voxeu, 2011

¹¹ ZENG D.Z., *Special Economic Zones: Lessons from the Global Experience*, PEDL Synthesis Paper Series, 2016, p.10

¹² TRAMPUS F., *Challenges, Threats and new opportunities for the world's Free Zones*, *Trasporti. Diritto, economia, politica* n. 89, 2003, p.73

- the government has developed and continues to operate in the free zone by not giving the private sector the opportunity to operate and invest¹³.

The unsuccessful Nigerian experience can be expanded to Africa in general which has not produced the expected results due to a few inefficient infrastructures and bureaucracies.

The consequence of this is that the introduction of SEZs could positively stimulate a struggling economy in the short term, but long-term problems, such as illegality, the infrastructural gap, an inefficient public administration, would soon arise.

Failures have also affected countries like Russia and India. In the first case, the country has created several areas at the same time, but this initiative was expensive and ineffective.

What the country has not done has been the management of a more comprehensive research in one or, at maximum, a couple of zones, to spur the development of a deeper strategy.

Providing tax incentives without creating the right economic environment around the area by imitating other countries can only lead to failure. In fact, the best strategy would be to take inspiration from other countries by adapting the strategy of others to the characteristics of the local economy¹⁴.

In the second case, the failure of Indian SEZs is due to both external and internal reasons.

Due to the global financial crisis of 2008, many countries, including the United States and the European Union, have reduced the demand for those products belonging to the main Indian export markets.

Instead, the internal reasons relate to defective policies especially with respect to the poor infrastructure linkages with the rest of the domestic economy and to the strong political resistance to acquiring land for SEZ development by the private sector¹⁵. Moreover, the Indian government made the unsuitable choice of promising a huge amount of benefits to attract companies but actually it had no funds to bear this effort.

Another example is Japan. According to its history, with many failures, there are legitimate worries that Japan's new zones will fail because central-government officials

¹³ NORMAN M., *Have 'Special Economic Zones' Entered the 21st Century Yet? A Tale of Two Cities*, Worldbank.org, 2014

¹⁴ SCHNEIDER G., *Special Economic Zones: Where Russia is getting it wrong*, Russia Direct, 2016

¹⁵ PALIT A., *India's Special Economic Zones: Failing to Take Off*, Ostasiatischer Verein e.V., 2016

reject ideas for deregulation for fear of offending vested interests. Among the optimal solutions, the government should bring in private developers to run zones.

The key elements of failed situations can be summarize into excessive bureaucracy, limited transport connectivity with trading destinations because too little is often spent on railways, roads and ports to link the zone to the rest of the world, high cost of utilities, poor site locations, uncompetitive policies, inadequate administrative structures and weak coordination between private developers and governments in infrastructure provision¹⁶.

In conclusion, there are important lessons to consider when the government wants to establish SEZs:

- firstly, it is important to separate political support from political objectives in projects; even if government commitment is necessary, projects must be created on the basis of specific strategic plans;
- although the free zone is conceived as an enclave, the success of the area depends almost completely on the competitiveness of the economy and on national investments And regardless of what is done inside the zones, they face challenges in linking the zones and global markets, including critical infrastructure challenges regarding ports, roads, and electricity; and
- a clear and transparent legal and regulatory framework is necessary to schedule the strategy and to establish the “rules of the game” for all stakeholders involved in the process, but also the implementation is of equal importance. In many special economic zones, the authority responsible for developing, promoting, and regulating the programme lacks resources and capacity as well as the institutional authority to carry out its mandate¹⁷.

¹⁶ FIAS (Foreign Investment Advisory Service), *Special Economic Zones: performance, lessons learned, and implications for zone development*, Washington DC, World Bank, 2008, p.5

¹⁷ FAROLE T., *Special economic zones: What have we learned?*, Voxeu, 2011

CONCLUSIONS

The changes in the global geo-economy and the progressive process of economic integration and of reduction of monetary barriers to national and international trade have profoundly changed the nature and the possible role of the free zones over the last few decades. While in the past these were mainly oriented to productive, manufacturing and commercial activities, they attached great importance to customs and fiscal advantages, they could focus on the location of large industries and were interpreted as a tool to promote local economic development, today they are oriented almost exclusively to commercial and distribution activities, they attach great importance to the variety and quality of the services offered, they take into account the localization of small and medium enterprises, which are seen as an instrument of an integrated strategy to stimulate regional competitiveness.

Currently, the concept of a free zone is not more limited exclusively to the provision of customs duty-free allowances, but rather it has been enriched by that of a free-trade zone, referred to by the English economists enterprise zones or exceptional free zone or, again, special economic zone.

Therefore, depending on the objectives the foreign company is willing to reach, it has to choose between the different possibilities of free zones:

- if the firm would like to promote the development of international trade, the free zone will take on a commercial nature;
- if the company would like to promote the development of industrial export activities, the free zone will take on an industrial nature; or
- if the firm would like to create conditions for business freedom with the aim of economic development and job creation, the free zone will take on a special nature.

However, the classical free zones also have limits for a concrete socio-economic development. In particular:

- 1) the commercial free zone is insufficient to ensure the economic recovery of a territory if not already highly competitive;
- 2) the industrial free zone:
 - a) provides for the export obligation and therefore it is not allowed to sell part of the goods on the domestic territory without formalities or payment of the necessary taxes;

- b) creates overcrowding of industrial and service activities in the chosen area.

Special free zones or business areas, on the other hand, have objective advantages for socio-economic development. From an examination of the existing ones, it should be noted that with this tool the free birth and development of entrepreneurial initiatives falling within the international traffic sector and the production of goods and services suitable for interacting with the surrounding productive fabric with a facilitating regime that should include:

- 1) customs advantages;
- 2) tax relief, namely:
 - a) exemptions from indirect taxation on the purchase of production factors;
 - b) reduction of direct taxation;
- 3) contribution reductions.

Therefore, based on what has just been stated, the notion of a business free zone is connected to the grant of a series of tax advantages, in favour of a limited geographical area within which were assigned to the enterprises located therein, significant benefits, not only of a tax nature, but also economic and financial.

The positive effect that derives from these various advantages could be defined as "local-global effect" that is a push towards the outside, exploiting local resources. In particular, among the positive effects, it is possible to highlight:

- the birth of a better and easier usability of the area by national and international operators;
- an attraction of local and foreign investments;
- an occupational development;
- an increase in the quality level;
- greater competitiveness.

As it has already been stated, the institution of the free zone plays an indispensable role for the territory if:

- a new legislation is developed, both nationally and internationally;
- there is a good and adequate strategy at the base, in fact it is the relevance of the special-economic-zone programmes in the specific context in which they are

introduced, and the effectiveness with which they are designed, implemented, and managed on an ongoing basis that will determine success or failure¹;

- the infrastructures, with the passing of time, are improved and gradually perfected;
- there is a good and efficient labour market;
- excellent coordination between local, regional and national policies; and
- high level of cooperation between companies.

In most cases, it is not so easy and immediate to find the right mix between these elements.

Concluding this analysis, it is possible to affirm that free zones are not only a tool for attracting companies and foreign capital but above all they are a way to implement tax reforms in a limited area to then evaluate the benefits, losses or various problems that could come to create and only later extend these reforms to the whole country if they were successful.

In any case the tax exemption regime, enjoyed by goods introduced in the free zone or free warehouse, allows companies that wish to exploit the services, to carry out operations of marketing, transformation and handling of goods without this leading to a burden in fiscal terms, with obvious advantages on the competitiveness of the territory and on the revival of national and international trade flows.

Free zones are very useful if they are well integrated with the local economy. In my opinion, the decision of a company that wants to operate in this kind of areas must not be based solely and exclusively on the percentages of exemption guaranteed by the state, but above all on the surrounding environment, therefore it must refer to the target audience, if the area is well connected so as to easily and quickly reach customers by reducing transport costs and so more competitive so that even the final price will be cheaper, what services and equipment are provided, if the infrastructure is good, if the country is politically stable, if there are good policies and if there is integration with the host country. At the same time, the State must provide the basic area and give individuals the opportunity to invest and operate in a way that has efficient and effective structures.

If on the one hand it is true that special economic zones boost economic opportunities, it is also true that they sometimes lack efficient law enforcement controls and regulatory

¹ FAROLE T., *Special economic zones: What have we learned?*, Voxeu.org, 2011

oversight. For this reason, sometimes companies take advantage of this lack to commit offenses such as money laundry and tax evasion.

Even if international free zones are normally defined as well-defined areas of the territory of a State that enjoy special facilitations in customs, taxation and labour law, notwithstanding the current legislation, while tax and banking havens are states or dependencies where the inflow or transit of international financial resources is encouraged by the offer of tax exemptions, accompanied by limited controls on the movement of capital or by the protection to the bitter end of banking secrecy, it is possible to argue that special economic zones are a kind of tax havens, but actually in a certain sense it is true because in both cases companies benefit from tax exemptions and reductions.

It is interesting to note that free ports and special economic zones are supposed to be territories with special rules (no VAT or custom duties, few controls, if any at all) because they are not considered regular parts of a country's territory, but rather logistical hubs where goods in transit are waiting to be delivered to their final destinations.

This concept has been addressed with regard to the area of Madeira as many people considered it as a tax haven. But, since the activities and operations carried out within the zone are regulated according to strict and transparent rules imposed by the European Union, the autonomous region of Madeira is not considered among the tax havens by the legislation in force in EU countries. Companies benefiting from the free zone that do not enter into commercial transactions with subjects resident in the Portuguese territory or with subsidiaries or parent companies resident there may benefit from the favourable tax regime.

In fact, one of the possibilities is that the parent company moves its subsidiaries into special economic zones in order to gain from income tax reduction or exemption.

The attempt of India to deter this phenomenon is interesting: the Reserve Bank of India has granted general permission to foreign companies to set up branches in special economic zones (SEZs) to undertake either manufacturing or services activities.

The permission will apply to those units which are in businesses where 100% foreign direct investment is allowed by the government. Moreover, these units have to function on a stand-alone basis. In other words, they cannot have any dealing with entities

outside the special economic zones in India, which include other branches or subsidiaries of their parent office in India.

Another solution could be the application of controlled foreign company (CFC) rules and more control on transfer pricing, solutions that are supported also by the OECD as part of the “base erosion and profit shifting (BEPS)” project.

In order to try to fight illegality, the European Union has established some requirements that companies must satisfy such as the obtaining of a license in Ireland, the creation of jobs for some years and a minimum amount of investments as it is the case of Portugal and Poland. Instead, in the USA companies must obtain the approval and then they will be monitored by the CPB as regards procedures and recordkeeping.

In any case, even if free zones are attractive because of the less rigid rules about customs procedures, in-depth controls should be made constantly to avoid these kinds of offenses.

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