

Table 1

## The Terminology of Free Zones

<b>FREE ZONES – THE EFFICIENT WAY OF ATTRACTING FOREIGN INVESTMENT</b>	
<b>1. Introduction</b>	
<p>One of the major trends in world economy is the emergence of free zones which demonstrated their role and usefulness in supporting economic development in many areas in the past decades. The present article is a monographic study of investment in free zones in Romania, an issue that has not been sufficiently analysed in specialised literature. There exist numerous free zones in the world and this is due to their effective promotion of business and to the fact that they have managed to operate well both in favourable economic contexts and during recession periods. In a similar way, they could provide our country with the special conditions, incentives and privileges that would attract foreign investment. Thus, the following free zones have been established, offering both legal facilities and the advantages of strategic location near inland waterways, maritime routes and, more recently, near air transport facilities: Constanța Sud Free Zone; Galați Free Zone; Sulina Free Zone; Giurgiu Free Zone; Braila Free Zone; Arad Curtici Free Zone.</p>	
<p>The stimulation of industrial and commercial activities through the creation of free zone facilities is beneficial to the national economy owing to both the growth in foreign currency earnings and the more effective use of the main abundant production factor – workforce – and the adoption of highly effective technologies and industrial equipment.</p>	
<p>There are 23, virtually synonymous, terms used in the specialised field literature to define the notion of free zone (Table 1).</p>	

Table 1

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Customs zone	Zonă de comerț
Customs free zone	Zonă liberă de comerț (scutită de taxe vamale)
Duty free export-processing zone	Zonă de prelucrare pentru export liberă de taxe
Export free zone	Zonă liberă de export
Export-processing free zone	Zonă liberă de prelucrare pentru export
Export-processing zone	Zonă de prelucrare pentru export
Foreign trade zone	Zonă de comerț exterior
Free economic zone	Zonă economică liberă
Free export-processing zone	Zonă de prelucrare pentru export liber
Free export zone	Zonă de export liber
Free production zone	Zonă de producție liberă
Free trade zone	Zonă de comerț liber
Free zone	Zonă liberă
Industrial export-processing	Zonă de prelucrare industrială pentru export
Industrial free zone	Zonă industrială liberă
Investment promotion zone	Zonă pentru investiții promoționale
Joint enterprise zone	Zonă antreprenorială mixtă
Maquiladora	Zonă de prelucrare pentru export
Privileged export zone	Zonă pentru export privilegiat
Special economic zone	Zonă economică specială
Tax free trade zone	Zonă de comerț liberă de taxe
Tax free zone	Zonă liberă de taxe
Zone of joint entrepreneurship	Zonă pentru întreprinderi comune

Source: "The Challenge of Free Economic Zones in Central and Eastern Europe, International Perspectives", United Nations, New York, 1991.

## **2. Romanian legislation on the creation and functioning of free zones**

The current Romanian legislation provides the adequate juridical conditions for the creation and functioning of free zones. Article 1 of the Law 84/1992 stipulates that free zones are established with the aim of promoting international commercial exchanges and attracting foreign capital so as to facilitate the introduction of new technologies and increase opportunities to use national economic resources, in maritime and inland river ports, along the Danube-Black Sea Canal and other shipping canals, and in the areas near the border [5].

A free zone represents a well delimited and enclosed part of the territory of a state, where goods are brought in or out, and commercial and industrial storage, processing and shipping operations are carried out, without being submitted to customs formalities. Free zones are usually located in ports but they can also function in airports, important train stations and other points within or near the country borders.

The decision to establish and delimit the free zone territories, and the corresponding customs and police units, is made by the Government, in accordance with a special bill, passed at the request of the concerned ministries and of the local public authorities. The main Government Decisions adopted in Romania concerning the establishment of free zones are listed in Annex no. 1.

## **3. Advantages provided by Romanian free zones to entrepreneurs**

The benefits of a free zone in our country largely depend on the advantages that it could offer to entrepreneurs, advantages that result in a decrease in Romania's foreign currency earnings.

The authorities' strategy concerning the fiscal and financial advantages and incentives will represent one of the fundamental components of our country's global strategy of attracting foreign investment in free zones. The advantages that Romania could provide to investors are:

A. The geographic position in Europe with access to the sea. There are indications that a free port in Constanta would attract Japanese investors willing to invest in: fish processing units, a chain of casinos on the

seaside, production and trade in wine and furniture, the production of Romanian marble. Also, many Japanese and South Korean investors have expressed their interest in the free zone near the town of Turnu Severin. The creation of a transshipping point in the modern port of Constanta Sud would create a major advantage for the companies that customarily use the Danube-Rhine navigation route. Moreover, we would like to mention that the Austrian firm Vests Alpine that took part in the modernization of the old port has already expressed interest in the creation of a transshipping point [2].

- B. The existence of available industrial capabilities.
- C. An internal market with a considerable absorption potential (bigger than that of most neighbouring countries).
- D. Competent, low-cost workforce.
- E. The goods it imports or exports that are not intended for the internal market are not submitted to custom duties or any other taxes.

When analysing the functioning of free zones, one can identify the following major disadvantages:

- the existence of companies that make minor investments in the zone but get a high profit rate;
- the risk of not recovering the investment made in the target country, a risk that is higher than in the case of conventional industrial development projects;
- the possibility of introducing noxious products that have damaging effects on the environment.

#### 4. Facilities provided to companies that invest in free zones

The terms of the new law for the promotion of foreign investment in Romanian represent a heartening start for the companies investing in free zones. As regards customs duties, foreign investors benefit of the advantages resulting from *Law no. 35/1991* concerning the regime of foreign investment:

- For their activities, companies are exempt of VAT, excises and profit tax during the whole of their activity. The transfer of the profits abroad is regulated by the law.

- On liquidation or limitation of activity, the foreign natural persons or legal entities can transfer the capital and profit abroad, after paying all their duties to the Romanian state and contractual partners.
- Romanian materials and accessories that enter the free zone and are used to produce goods are exempt of customs duties, export formalities being observed.
- Romanian goods used in construction, service or maintenance of sites located within the free zone are exempt of customs duties, export formalities being observed.
- The financial operations related to activities in the free zone are carried out in convertible currency.
- Any type of structure intended for any purposes can be built on the territory of a free zone, provided Romanian legislation is observed.
- Goods in a free zone can be transferred to another customs zone, tax exempt. Additionally, these goods can be imported or temporarily received in the country observing all the legal terms and formalities.
- Investments made in free zones cannot be expropriated, requisitioned or submitted to any other measures with similar effects, except in cases of public interest, observing legislation and providing prompt, adequate and effective damages proportionate to the value of the investment.

### **5. Opportunities of using free zones in Romania**

Most free zones in Romania are transport-oriented and financially potent foreign investors are expected to settle there. Ukrainian and Russian enterprises are expected to be interested in the free zones located in the area of the inland ports of Galați and Brăila. It is worth noting that there already exists a broad gauge railway which reaches close to Galați and which could be extended by another 30 km to Brăila (without considerable expenses). In the vicinity of Porțile de Fier, near Turnu Severin there will be the only zone on the Danube riverside operating mainly in production and assembling.

The effectiveness of free zones consists in the rising overall earnings, the introduction of modern technologies, the speeding up import, export and transit operations, and the production of goods in more advantageous

circumstances. Free zones allow limited administrative formalities, reduced storage and warehousing costs, the absence of import and export contingencies, the repatriation of profits.

One could take as an example the development of the Giurgiu Free Zone that became the largest in Romania when, in December 2000, its surface expanded by circa 109 ha following the addition of the first platform of the former local chemical plant. Sources from the Giurgiu Free Zone Administration declared at the beginning of 2001 that an important German concern was interested in leasing the whole surface of the platform in order to build a wood prefab plant. 28% Out of the 450 companies operating in the Giurgiu Free Zone have foreign capital originating from France, Italy, Greece, England, Germany, Cyprus, Holland, the United States, etc. The Giurgiu Free Zone Administration estimates that by the end of 2001 the national budget will take in approximately 800 billion lei in taxes, customs duties and other earnings. In 2000, the revenues amounted to 500 billion lei as opposed to 280 billion lei in 1999.

There has been only one major investment in the five existing free zones in Romania: General Investment has leased 1,400 sq m in Brăila. All work has been concentrated in the 3<sup>rd</sup> perimeter of the Brăila Free Zone, where a railway and a road have been built to facilitate the activity of the investing companies. The 6.9 hectare-3<sup>rd</sup> perimeter is located in the port area in the centre of the city. The docks for maritime ships of up to 15,000 tdw are also there. Maergk Company has run a transport of containers worth \$ 200,000, the contract being under way. DASSA – an Arad-based company – has set up the equipment for a peanut-processing plant, being expected to process four to five thousand tons of peanuts per month.

Approximately 70% of the surface of the Arad-Curtici Free Zone has been leased by investors that have expressed their firm intention to invest there after the free zone will effectively start functioning. Most of them are interested in productive activities, in the fields of textiles, informatics, car components, and in addition there are several dealers representing major car producers. Many companies wish to operate their businesses in Romania directly from the free zone, owing to the facilities they will be provided with there. An Austrian firm, Lagermax, owning the largest storage areas for new cars in Hungary, has already leased 2.5 ha in Curtici, on the land of the future free zone. The firm is a dealer for well-known brands such as

Mercedes, Audi, Volkswagen and Skoda and has retail outlets in several cities in Romania, among which Târgu Mureş, Cluj, Constanţa and Bucharest.

Professional researches have shown that in some free zones in Romania the contribution of foreign investment to the growth of the hard currency reserves has not been significant. This is due to the lack of complexity of the industries set up there, which do not require considerable capital input and are based on intensive work. The profit of foreign companies resulting from investing their capital there is in most cases repatriated and not locally invested. According to World Bank assessments, the guest country receives only 20% to 40% of the level of export earnings in a free zone. The level of imports is variable and depends on the degree of integration of the free zone with the respective national economy. It can sometimes rise to 30 % of the initial set-up costs. The average net export profits of the guest country do not usually exceed 25 % and may also be below this figure. The contribution of the guest country in free zone exports is on average 1-2%, obviously very low.

## 6. Proposals

Two prerequisites for the success of a free zone are promotion and effective marketing [4]. An essential distinction between free zones in Romania and those in other countries is that the former are not known abroad. This is why promotion and marketing should be more elaborate. A professional firm should conduct a world market study in order to identify potential investors as well as the value of the expected investments. Such a study will have a double positive effect. First of all, it will pinpoint the required type of products and free zone. Secondarily, it will establish the type of profitable activity to be deployed and establish the revenues to be subsequently obtained. Research has shown that a small export-processing zone, aiming to employ 10,000 to 20,000 jobs in 5 years, will normally invest \$ 1 dollars per year for promotion and advertising [3].

Usually, it takes 10 years for a free zone to be completely occupied. The number of incoming foreign investors is not uniform. After 7–8 years, 50 % of the zone is occupied, the other half being occupied in the following 2 years.

One of the actions to be taken in the existing free zones is the promoting varied industrial units, even if their productive potential is generally low.

The completion of the establishment of the Agigea-Sud Free Zone is essential for the growth of international traffic on the Danube-Black Sea Canal. It is estimated that the establishment of the Agigea-Sud Constanța export-processing free zone and the Basarabi industrial processing free zone will have a favourable impact on the national economy. The Japanese investors have expressed their interest in setting up the infrastructures, announcing potential investments of \$ 100 million and the establishment of a Romanian – Japanese bank, with a starting capital of \$ 500 million.

The creation of the Black Sea economic zone is a major advantage for the development of international co-operation. The organisation includes 11 states, most of them members of the former CAER. The creation of the zone will be achieved through the harmonization of the member states' legislation on customs, financial and banking regulations, on the unification of external trade regimes and the promotion of a common policy in the field of bilateral and regional commercial exchanges, in keeping with the rulings of the World Trade Organization.

Romania's integration is highly complex and involves increased interdependency between different states. Thus the economic integration of the Republic of Moldova and Romania will involve three successive stages, namely:

- a) customs and economic union;
- b) monetary union;
- c) social union.

Initially, free zones should be established on the territories of the two states to ensure the free movement of people, goods, services, and capitals. There exist several geo-economic factors favourable to the creation of free zones as nuclei for the Romanian-Moldavian integration. They possible locations could be:

- Ungheni (Iași county) – Ungheni (Moldova);
- Albița (Vaslui county) – Leușeni (Moldova);
- Galați (Galați county) – Giurgiulești (Moldova).



## Annex 1

**Government Decisions adopted in Romania concerning the establishment of free zones**

1. **Government Decision 156/22 April 1993 – M. Of 108 – 27.05.1993 on the establishment of the Sulina Free Zone and the “Administration of the Sulina Free Zone”.**  
**Amendments:**
  - Government Decision 963/29 December 1994 – M. Of. 373 – 30.12. 1994;
  - Government Decision 682/7 October 1994 – M. Of. 311 – 08.11.1994;
  - Government Decision 1186/15 November 1996 – M. Of. 307 – 26.11.1996.
2. **Government Decision 410/16 August 1993 – M. Of. 216 – 02.11. 1993 on the establishment of the Constanța Sud Free Zone, and the Autonomous Company “Administration of the Constanța Sud Free Zone”.**  
**Amendments:**
  - Government Decision 682/ 7 October 1994 / M. Of. 311 – 08.10.1994;
  - Government Decision 191/8 May 1997 – M. Of. 101 – 27.05.1997.
3. **Government Decision 190/26 April 1994 – M. Of. 120 - 13.05.1994 on the establishment of the Galati Free Zone, and the Autonomous Company “Administration of the Galati Free Zone”**
4. **Government Decision 330/22 June 1994 – M. Of. 178 – 13.07.1994 on the establishment of the Brăila Free Zone, and the Autonomous Company “Administration of the Brăila Free Zone”**
5. **Government Decision 788/11 September 1996 – M. Of. 248 – 14.10.1996 on the establishment of the Giurgiu Free Zone, and the Autonomous Company “Administration of the Giurgiu Free Zone”**  
**Amendment:**
  - Government Decision 336/29 June 1998 – M. Of. 239 – 30.06.1998

6. Government Decision 191/8 May 1997 – M. Of. 101 – 27.05.1997 for the amendment of the Government Decision 410/1993 on the establishment of the Constanța Sud Free Zone, and the Autonomous Company “Administration of the Constanța Sud Free Zone”  
Amendment:  
– Government Decision 788/2 December 1997 – M. Of. 391 – 31.12.1997 for amending and supplementing the Government Decision 410/1993 on the establishment of the Constanța Sud Free Zone, and the Autonomous Company “Administration of the Constanța Sud Free Zone”.
7. Government Decision 336/29 June 1998 – M. Of. 239 – 30.06.1998 for amending provisions in the Government Decision 788/1996 on the establishment of the Giurgiu Free Zone, and the Autonomous Company “Administration of the Giurgiu Free Zone”.
8. Government Decision 449/8 June 1999 – M. Of. 264 – 09.06.1999 on the establishment of the Curtici - Arad Free Zone, and the Autonomous Company “Administration of the Curtici - Arad Free Zone”.
9. Government Decision 824/7 Octobér 1999 – M. Of. 494 – 13.10.1999 for the amendment of paragraph (1) of article 16 of the Government Decision on the establishment of the Curtici-Arad Free Zone, and the Autonomous Company “Administration of the Curtici-Arad Free Zone”.

### References

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3. Enache, Elena, *Managementul zonelor libere contemporane*, Independența Economică Publishing House, 1998, p. 88.
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5. Law number 84/1992 on the establishment of free zones.
6. The collection of *Tribuna Economică* magazines, 1991-2001.