

THE ARRANGEMENT OF FREE ECONOMIC ZONES IN AZERBAIJAN: SUBSTANTIATION AND SPECIALIZATION OF TERRITORIAL SELECTION

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Introduction

Currently, over 4000 Free economic zones (FEZ) of various specialization function in 138 countries of the world. Over 5 mln people are employed and over \$ 500 bln has been invested in these zones.

In recent years, the growth of interest in the establishment of FEZs has been noticed in Azerbaijan. While the discussions regarding it were limited to a certain extent in mid 90s, during the following period, the proposals over the matter were reflected in the press, thereby raising public awareness.

It is natural that establishment of market relations, increase of economic contacts and expansion of investment opportunities caused the necessity of setting up FEZs. But, it is too early to speak about the well-considered and consistent regional development policy over the matter. As an example, it is worth to note that the leadership of Ministry of Economic Development voiced various contradictory views as regards FEZs (from selection of different territories for FEZs to complete letup of the discussion over the matter). In our view, the fact that an opinion regarding a concept for setting up FEZs has not been formed yet in the republic is one of the key reasons for the existing situation. Above all, the objective to set up a FEZ should be specified for each region separately in a conception to be worked up.

As we know, the primary aim to set up FEZs is to attract investments, open new work places, use favorable geographical location of a territory and its transport facilities, as well as to stimulate the development of the country's remote and undeveloped regions. Since every FEZ has a unique transport and geographical location, economic opportunities and skilled labour resources, the state should certainly set distinctive objectives for creating FEZs. Therefore, the use of international practice can help successful achievement of the stipulated objective.¹

The practice of foreign countries

The World Economic Processing Zones Association (WEPZA) established by the UN in 1978, acquaints the interested parties with positive experience of FEZs functioning in different countries at its annual meetings. A different development level of countries and their economic and financial opportunities require distinctive aims for setting up FEZs. In most cases, the primary aim to set up a FEZ is to eliminate inequality in the regional development of a developed country, but as for a developing country – to attract foreign investments is foremost.

To take useful advantage of foreign practice, the countries, the socio-economic conditions and geographical location of which are similar to those of our country, should be taken as an example. Unfortunately, the United Arab Emirates, Dubai (the Jabal Ali FEZ) is taken as an example in our country. For comparison: 126 mln tons of oil and 45 bln m³ of natural gas is produced in the above country, population of which is 3,4 mln people. The volume of GDP per head makes \$ 26 thousand².

To our mind, it would be more useful to study unsuccessful experience of the European Union to set up FEZs in the Maghreb States (Arabian countries at the coast of the Mediterranean Sea). Although the EU declared it was ready to allocate \$ 10 bln to this project, 4 out of 10 Maghreb States didn't support an agreement signed in 1995³. Thus, the economy Algeria much depends on its oil revenues, but its other economic spheres are not equally developed. Algeria's such position is caused by the protection of domestic market.

The practice of some countries (China, Poland, Philippines, Turkey, Iran, and Russia etc.) can prove that the main preference is given to ports with access to a sea or marginal regions. Azerbaijan's access to the closed Caspian Sea may be relatively favourable, but Georgia's access to the Black Sea is considered much more advantageous comparatively. Therefore, the "Dubai Port World" Co. is planning to allocate \$ 700 mln investment to the FEZ's container port to be set up near the Poti.

It is necessary to pay attention to neighbour countries' policy regarding the establishment of FEZs in marginal regions. For instance, Iran is setting up FEZs in the regions bordering with Azerbaijan: "Araz" in Julfa and FEZs in Astara and Bandar-Anzali. It is worth to note that the state and private sector of Armenia are carrying out the activity in the "Araz" FEZ.

Dagestan's proposal to set up a FEZ in its territory in 1996 was turned down by the Russian Parliament (Duma). Russia's such position can be explained due to the separatism danger. At present, only two FEZs operate in Kaliningrad and Magadan provinces - Russia's most remote western and eastern regions.

In Turkey, the FEZs have been set up in its western coastal part. Such a step stimulated the development of this region, as well as entirely intensified the difference among western and eastern regions in terms of socio-economic development.

The FEZs (Kalmykia-based Lagan port in Russia, the Aktau port in Kazakhstan, Bandar-Anzaly port in Iran), set up in the coastal regions of the Caspian Sea, haven't justified themselves so far.

The world practice of FEZs shows that the realization of a policy concerning the establishment and gradual development of such zones will define the efficiency of their activity. Besides, FEZs can't develop independently without a state support. Therefore, the state's comprehensive policy in this sphere will enable to achieve an ultimate goal.

The establishment of FEZs and their successful activity depend on the following factors:

- favourable geographical location for functional foreign economic relations;
- natural resource potential;
- development level of transport network;
- working experience meeting international standards;
- sufficient labour resources and availability of skilled specialists;
- socio-economic, ecological and geopolitical situation in a region.

Existing state regarding the establishment of FEZ in Azerbaijan

As to the selection of territories for FEZs, a tax remissions period should be defined. In most cases, this period swings from 10 to 20 years.

Primarily, setting up FEZs in Azerbaijan can be one of the means to eliminate the disbalance existing in socio-economic development of the country from a territorial viewpoint. In this regard, the most important matter is the accurate selection of FEZ territories. From a scientific viewpoint, correct territorial selection provides the basis for overall success. Otherwise, the idea to set up a FEZ can result in fiasco (one can take the Sumgayit industrial zone and Yeni Yashma FEZ as an example).

It should be taken into consideration that FEZs are independent of a central government from administrative and economic standpoint. Therefore, the results of establishment of such zones in the territories with separatism danger should be taken into account. In conditions of Azerbaijan, the selection of territories for FEZs should be analyzed at several levels.

Level 1 – the selection of a territory should be grounded on the country's regional development strategy. Unfortunately, it is impossible to talk about a well-considered regional development policy so far. The superficially worked up "State Program on socio-economic development of regions hasn't yet enabled the utilization of quite great volume of regions' natural resource potential. Therefore, the socio-economic development of regions hasn't reached the relevant level. Although the commissioning of each enterprise or the

construction of a social establishment in regions seemingly portrays the revival, they have a number of most important and pending problems. It is clear that the country's regional development policy should be worked out according to the varying status of our relations with neighbouring countries.

Therefore, at the **Level 2**, the matter should be analyzed based on "attracting" or "avoiding" peculiarities of marginal regions. Azerbaijan has a direct overland access to Iran, Russia and Georgia, as well as to Turkey through Nakhichevan. Our frontier regions are still under occupation in the state of war (temporarily seized) by invader Armenian state. Since the marginal regions in the north, west and south have distinctive geographical, natural resource and human potential and at the same time the distinctive relations with neighbouring countries, the FEZs territories should be defined. The establishment of FEZs in marginal regions will cause integration of the country's economy to the world economy and strengthening of international economic contacts.

Level 3 – a region's favourable opportunities (climate conditions, geographical location, resource potential, developed transport infrastructure, labour resources, material and technical base etc.) for establishment of FEZs. For instance: Sumgayit city was proposed based on such approach, however, it was contradictory to the strategic and regional development of the republic. Before the establishment of FEZ, the distribution of foreign investments over the territories and spheres in the country within the last 5–10 years should be analyzed. In this regard, it is possible to imagine the attractive differences of economic spheres and regions from the investment viewpoint.

Thus, two primary factors should be taken into account in the selection of an appropriate territory for a FEZ.

1. Its compliance with the country's regional development strategy
2. The probability of foreign investors' interest in a territory

Taking into account the above views, technical and economic substantiation of the FEZ establishment should be carried out. The technical-economic substantiation to be worked up should consist of the following sections:

- the primary objective to establish a FEZ;
- the assessment of main factors for the establishment of a FEZ;
- the Assessment of a territory selected for the FEZ establishment (bases of selection);
- the development program of a FEZ;
- its financial infrastructure and technical opportunities;
- territorial arrangement and the activity of administrative system;
- the assessment of a FEZ's activity and its long-term development.

FEZs are divided into various types according to the world practice. More prevailing FEZ types are as follows:

- special economic zones;
- special trade zones;
- industrial zones;
- recreation-tourist zones;
- information technologies parks;
- finance-bank zones.

The selection of territories for FEZs is done under various demands. Therefore, the specialization of FEZs in the republic should be defined in advance. The urgency of this matter arises from a law to be worked up regarding FEZs.

A law on a FEZ should specify legal and economic essentialities of its establishment and activity. At the same time, it is worth to get acquainted with the achievements of neighbour-states in this sphere for the adoption of laws regarding FEZs in our republic. For instance, in Turkey, the law on FEZs was adopted in 1985, in Iran and Turkmenistan in 1993 and Russia in 2005. Such laws haven't been adopted yet in other neighbour-states. However, the first FEZs can function according to a presidential decree.

Proposals over the establishment of FEZs

In the regional development policy of a country, a risk degree should be taken into consideration while planning FEZs. The possible risks are as follows:

- the formal registration of monopolist-enterprises to evade tax payment;
- decrease of budget revenues to be gained as a result of economic and trade relations;
- intensification of inequality in the development of regions (in case FEZs are established in the east of the republic);
- increase of a territory's economic independence and decrease of its central dependence may result in the upsurge of separatist forces;
- failure of a project due to the inexperience of local authorities;

A state should work up a proper regulatory mechanism to decrease the probability of any risk.

Taking into account the facts mentioned, we think that the following territories can be primarily considered as an initial variant of setting up a FEZ in the republic.

1. A "Special trade zone" in the so-called Girmizi Korpu (Red Bridge) borderline territory.

2. A "Special trade zone" in the borderline territory of Sadarak region.

3. A "Special tourism zone" on Nargin and Pirallahi islands.

It is expedient to consider the establishment of FEZs in these territories. The special economic zones should be compact from territorial and administrative standpoints. As a result, economic growth may happen in the mentioned territories, the country's economic contacts may expand and Azerbaijan's importance may considerably increase.

¹ **Opportunities** and Challenges for Free Zones in a Globalizing Economy. A Publication of the World Economic Processing Zones Association. Arizona. 2007.

² **Asim Al** Abbasi Successful Zone Strategies in Jabel Ali – Proceedings International Conference WEPZA. Antalya. 2007.

³ **Anthony Kleitz**. The Role of EPZs in Trade Development – Proceedings International Conference WEPZA. Antalya. 2007.