



Special Economic Zones as an Engine of Regional Economic Development: the best Practices and Implications for Uzbekistan

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Abstract: Special economic zones (SEZs) are considered as an effective tool to stimulate industrialization and structural transformation, but only when implemented properly in the right context. The aim of the paper is to review the existing practices of establishment of Special Economic Zones using the case successful countries including China, Korea, Singapore and the UAE and explain how they contribute for the development of regional economy. Moreover, the current paper provides the latest initiatives taken by the Uzbek government to establish Special Economic Zones as a main tool of foreign direct investment attraction and provides some recommendations for further improvement based on the successful practices. Special economic zones (SEZs) are booming around the globe. The zones can be effective tools to endorse economic development if applied properly in the right context. The aim of this paper is to give recommendations for the success of Uzbek SEZ based on the global experience of successful countries such as China, Korea and Singapore.

Keywords: SEZ, Economic development, Cluster, Free trade zone

1. Introduction

Special economic zones are considered as a generic term. In other words, it represents different variations of traditional commercial zones. In this regard, it is worth to mention a number of characteristics of special economic zones. Special economic zones are regarded as geographically delimited area which is physically secured (Ganne, 2009). Special economic zones have their own management system. Given its geographic location, special economic zones offer a number of benefits and it has duty free benefits (Farole, 2011). Another characteristic of special economic is that they operate under more liberal laws. Moreover, creation of special economic zones leads to a number of benefits, which can be described by dividing them into two categories including direct economic benefits and indirect economic benefits (Carmody, 2009). Direct economic benefits include the creation of job opportunities and foreign exchange whereas indirect benefits are more about transfer of new technology and skills. More detailed information about direct and indirect benefits can be found from the table below:

Table 1

	Direct benefits	Indirect benefits
Foreign Exchange earnings	■	
FDI	■	
Employment generation	■	
Government revenue	■	
Export growth	■	
Skills upgrading		■
Testing field for wider economic reform		■
Technology transfer		■
Demonstration effect		■
Export diversification		■
Enhancing trade efficiency of domestic firms		■

Source: Zeng (2012)

2. Research Problem and Objectives

Most of the developing countries focus on developing regional economy practices by establishing free economic zones. One of the main motives behind establishing free economic zones is to attract foreign direct investment. However, these emerging countries lack relevant expertise and knowledge to make full use of available SEZ. In this regard, considering the SEZ practices of China, which was one of the first countries succeeding in establishment of SEZ can provide potential benefits. This paper aims to provide recommendations for the success of Uzbek SEZ based on the global experience of successful countries such as China, Korea and Singapore.

Particularly, this paper tries to fulfill the following objectives:

- To identify the nature of SEZ including its main types and benefits
- To distinguish between industrial cluster and SEZ
- To review the practices of successful countries in terms of establishing SEZ
- To offer recommendation for SEZ development in the case of Uzbekistan using the best practices.

3. The main characteristics and types of SEZ

Table 2

Name	Definition
Free Trade Zones	FTZs (also known as commercial-free zones) are fenced-in, duty-free areas, offering warehousing, storage, and distribution facilities for trade, transshipment, and re-export operations.
Export Processing Zones	EPZs are industrial estates aimed primarily at foreign markets. They offer firms free-trade conditions and a liberal regulatory environment. There are in general two types of EPZs: one is a comprehensive type, open to all industries; another is a specialized type, only open for certain specialized sectors/products.
Comprehensive Special Economic Zones	Comprehensive SEZs (also called “Multi-functional Economic Zones”) are zones of a large size that have with a mix of different, industrial, service and urban-amenity operations. In some cases these zones can encompass a whole city or jurisdiction, such as Shenzhen (city) and Hainan (province) in China.
Industrial Parks	Industrial Parks (also called “Industrial Zones”) are largely manufacturing-based sites. Some multi-functional ones similar to “Comprehensive Special Economic Zones” (listed above) exist, but usually operate at a smaller scale. The parks normally offer a broad set of incentives and benefits.
Bonded Area	Bonded Areas (also known as “Bonded Warehouses”) are specific buildings or other secured areas in which goods may be stored, be manipulated, or may undergo manufacturing operations without payment of duties that would ordinarily be imposed. To some extent, a “bonded area” is similar to a “free trade zone” or “free port.” However, the major difference is that a “bonded area” is subject to customs laws and regulations, while a “free trade zone” is exempt from these provisions.
Specialized Zones	Specialized Zones include science/technology parks, petrochemical zones, logistics parks and airport-based zones.
Eco-Industrial Zones or Parks	Eco-industrial zones or parks focus on ecological improvements in terms of reducing waste and improving the environmental performance of firms. They often use an “Industrial symbiosis” concept and green technologies to achieve energy and resource efficiency. Given the severe environmental challenges, an increasing number of countries is embracing this new type of zone.

Source: Zeng (2012)

The term Special Economic Zones include free trade zones, export-processing zones, industrial parks, free ports, and enterprise zones (Chiao, 2010). In the case of China, term SEZ is considered as a broad concept since Chinese SEZ are quite diverse in terms of functionality and consist of large land areas. In the case of China, SEZ consist of seven zones including Shenzhen, Zhuhai, Shantou, Xiamen, Hainan, Shanghai Pudong New Area, and Tianjin Binhai New Area (Hu, 2009).

3.1 Industrial cluster

Industrial clusters are considered as geographic area where there are large number of interconnected firms which operate in the same or related industries (Krugman, 1996). Mainly, educational institutions, financial organizations and various government levels are included in the category of industrial clusters. In most of the cases, these organizations are located to each other very closely (McCormick, 2007). It can be seen from the practices of both developed and developing countries increasing reliance on industrial cluster to develop economic growth. One of the famous business professor and father of business strategy, Porter popularized the concept of clusters in his book “The Competitive Advantage of Nations”. Precisely, Porter viewed clusters as an important mechanism that enables the government to make better use of existing resources which results in achieving regional, national and international competitive advantage. There has been a strong debate among scientist regarding the importance of clusters in fostering the innovation (Yeung, 2009). The collective efficiency model proposed by Nadvi highlights the importance of main variables that help companies to identify their competitiveness in industrial clusters (Zeng, 2001). They include market access, attracting and improving labor market and transfer of new technologies, which are critical in fostering the innovation.

However, clusters are not always found to positively contribute to innovation. Moreover, innovative clusters do not necessarily imply high technology clusters (Zhong, 2009). Geographic proximity of organizations does not always result in learning and innovation. Although clusters do not directly result in innovation, the environment where industrial clusters operate result in creating favorable conditions for stimulating the innovation.

4. SEZs and Clusters: “Top-Down” Versus “Bottom-Up”?

Special economic zones are mainly established using a “top-down” approach by the initiative of the government organizations whereas most of the industrial clusters are formulated in an organic way based on the “bottom-up” approach (Schott, 2008). Industrial parks and export processing zones have resulted in the creation of clusters over the time and it is particularly observed in the case of developing countries.

Table 3

Cluster type growth	Characteristics of member firms	Intra-cluster interdependencies	Prospects for employment
Marshallian	Small and medium-size locally owned firms	Substantial inter-firm trade and collaboration;	Dependent on synergies and economies provided by cluster
Hub and spoke	One or several large firms with numerous smaller supplier and service firms	Cooperation between large firms and smaller suppliers on terms of the large firms (hub firms)	Dependent on growth prospects of large firms
Satellite platform	Medium-size and large branch plants	Minimum inter-firm trade and networking	Dependent on ability to recruit and retain branch plants
State anchored	Large public or nonprofit entity related supplier and service firms	Restricted to purchase-sale relationships between public entity and suppliers	Dependent on region’s ability to expand political support for public facility

Source: Zeng (2012)

The establishment of clusters takes a long time therefore there should be particular ecosystem. In this regard, it should be noted that cluster formulation using “top-down” approach should be done carefully.

The challenges that are faced by Chinese government did not prevent them from working on establishing cluster (Zhong, 2009). This was mainly done by improving the business environment in the country. In some cases, it is possible for government to choose the mixture of top down and bottom up approaches in establishing clusters. In many cases, it has been observed that government have more control when it comes to SEZ development compared to the development of industrial clusters (Jensen, 2014). However, it does not necessarily mean that the creation of industrial clusters are easy job to do and this was the main reason for the failure of many SEZ. The success of the SEZ is strongly dependent on good governance and well established market as well as ecosystem (Wang, 2005). The government has a good understanding about the national comparative advantage, thus, they can use this information for the benefit of establishing SEZ.

4.1 Chinese Practice

In the last 30 years, economic growth of China has reached phenomenal rates and it was considered as “miracle” in the history (Hu, 2009). It might be interesting for many of us to know how China has achieved such a growth rate and what were the main drivers of Chinese economy. The last not least, many scientists and experts are interested in knowing can China sustain the current growth rate in the long term as well (Xiaoyang, 2011). Although many experts and scientists are providing number of arguments and even though there is a hot debate in this topic, presence of special economic zones and industrial clusters which were established after the new reforms in China, can be regarded as Chinese main drivers of economic growth. In other words, the establishment of special economic zones and industrial clusters positively contributed for the economic development of the China (Farole, 2011). Precisely, it is worth to mention that first established economic zones were tested inly in limited number of Chinese cities and the role model of the those which were successful were followed by other countries. Alongside with industrial clusters, special economic zones have made positive contribution for the increase in gross domestic product, employment rate increase and development of international trade which can be explained by increase in exports and attraction of foreign direct investment (Carmody, 2009). Another important contribution of establishing free economic zones can be explained with the attraction of new technologies to China and adoption of new technologies in the daily practices (Chiao, 2010).

The practice of China shows that market forces play an important role in the creation of industrial clusters (WTO, 2008). It is worth to mention that government also play an active role in the supporting and facilitating the process of industrial cluster creation. The initial step in formulating the industrial clusters start with the establishment of the industrial parks. After the long years of development, some clusters emerge from the existing SEZ (Zhao, 2005). In the example of China, we can provide the example of information and communication technology clusters in Beijing and electronics cluster in Shanghai, software cluster in Dalian and opto-electronics cluster in Wuhan. These clusters became successful as a result of being established as SEZ (Hu, 2009). Moreover, recently in China some cities began to establish cluster type of industrial parks also known as specialized industrial parks including liquid crystal display high tech park in Jiangsu Province (Ganne, 2009). In the case of China, SEZ operates in more technological and capital intensive sectors and there is a tremendous government support, foreign direct investment and it has a strong link to global market (Xiaoyang, 2011). When it comes to clusters, they operate in less labor intensive and capital intensive sectors and they receive less government support.

4.1 Korean SEZ

Another successful implementation of SEZ can be seen in the case of Korea, which became a role model for many countries. One of the important factors that contributed to the success of Korean SEZ can be considered as excellent locations (McCormick, 2007). Moreover, in order to maximize the productivity of SEZ, Korean government has also offered beneficial environment for foreign companies to invest by providing them rental land and number of favorable incentives. For instance, Masan Free Trade Zone which is regarded as one of the most successful Korean SEZ is famous for its renowned foreign enterprises including Nokia, Sanyo, Sony which is considered as concentrated clusters. Another important characteristic of Korean SEZ is their strong relations with local governments which enable local companies to benefit from the advanced technologies, employment opportunities which is regarded as an engine for local economy development. In summary, there are five main important factors which contributed to the success of SEZ development in Korea. They include excellent location, timing, one-stop service provision, and strong support of the Korean government and involvement of large multinational companies (Farole, 2011).

4.2 Uzbekistan

In the conditions of liberalization and modernization of the economy, Uzbekistan aims to create favorable conditions for the attraction of foreign direct investment and attraction of FDI plays a crucial role to supply the local market with products and services of international standards. In this regard, government of Uzbekistan relies on establishing special economic zones (Worldbank, 2010).

Free economic zones are established with the aim of promoting economic development of the specific region or industrial sector. Moreover, SEZ plays a critical role in improving the regional economy particularly for the countries that are in the process of transition to the market economy. In this regard, it is worth to mention that free economic zones are not only important in terms of attracting foreign direct investment but also critical while transition to market economy. The review of the literature shows that if special economic zones are established in areas with relevant tax exemptions and custom preferences, their share in GDP of the country raises significantly. For example, special economic zones in Manaus constitute the half share of the domestic product in the region. As a result, new work places are created. Moreover, more products have been produced and exported. Given its positive sides, local government prolonged the activities of SEZ and offered additional benefits. After observing the international experience, Uzbekistan has also adopted new laws and legislations that aim on creating the favorable conditions for attraction of foreign direct investment by creating free economic zones. The first three free economic zones include free industrial economic zone Navoi, special industrial zone Angren and special industrial zone Djizakh.

Free industrial zone of Navoi was established according to the decree of Republic of Uzbekistan in 2008 and its main aim is to develop high tech industries, modern high efficiency equipment, machinery and production lines as well as innovative technologies.

The new president of Uzbekistan has also adopted a presidential decree in 2017 about creating free economic zones of Urgut, Gijduvon, Kokand and Khazorasp. These free economic zones are established in the aim of producing the high value added competitive products which are exported. Moreover, these economic zones play a crucial role in attracting the foreign direct investment and new technology. The establishment of free economic zones play an important role in effective utilization of labor force available in these regions. Moreover, the creation of SEZ in these regions enable the regions to develop the local economy and develop entrepreneurial capability of local people as well by creating them lots of employment opportunities.

Special allowances have been ratified for the development of specific areas of Uzbekistan. The following Free Economic Zones have been created:

- Navoi Free Economic Zone;
- Angren Free Economic Zone;
- Dzhizak Free Economic Zone;
- Urgut Free Economic Zone;
- Gijduvon Free Economic Zone;
- Kokand Free Economic Zone;
- Hazorasp Free Economic Zone.

Subject to the value of foreign investment, companies are eligible for allowances of varying duration on:

- land tax;
- property tax;
- corporate profits tax;
- tax on improvements and the development of social infrastructure and others.

As a further incentive, special rules for making payments in foreign currency have been presented for companies registered in the above zones.

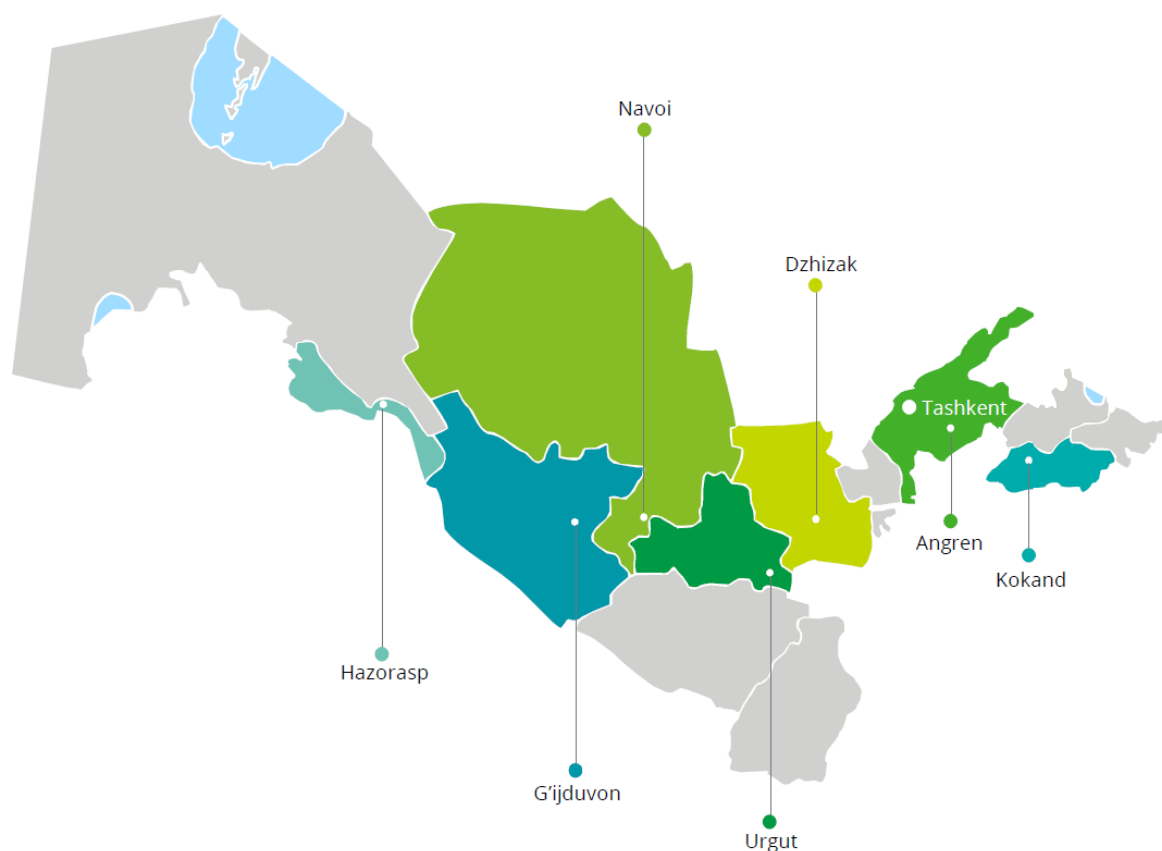


Figure 1

Source: (Deloitte, 2015)

5. Conclusion and Recommendations

SEZ is becoming popular due to the rapidly changing global economic and market conditions. For example, such countries as China have declared specific cities and even provinces as SEZ in order to test market oriented economic reforms. This practice has become common in many East Asian and Latin American countries. Moreover, increasing global concern over climate changes has even more stressed the importance of formulating SEZ which can be considered as new trend towards environmental sustainability. Most of the successful SEZ has been built by taking into consideration the host countries specific conditions and they are built based on these countries comparative advantage. In this regard, it is important to have a long term vision since economic reforms take long time to occur.

Particularly, the following recommendations can be provided.

5.1 Strong Government Support as a Part of the Long Term Strategy Development

SEZ programs should be integral part of countries regional and national development. The experience of successful countries such as China, Korea, the UAE and Singapore support this point (Hu, 2009). These countries treat SEZ programs as a critical part of their regional economic reforms. Thus, top level of the government also provides the necessary support to ensure the political support. For instance, in South Korea exports were considered as a main priority during the country's industrialization process and this was mainly achieved through establishing SEZ. In the case of China, SEZ is regarded as a main instrument to facilitate the national and regional reforms.

5.2 High Level of Infrastructure

One of the main aims of SEZ should focus on overcoming the main obstacles while doing business. In this regard, economic zones should also have good infrastructure such as availability of power, water, roads and telecommunications (ADB, 2007). Only after having good infrastructure, economic zones can be used to support

economic development by offering tax incentives and simplifies customs procedures as it can be seen from the practice of East Asian countries. Precisely, economic zones in Singapore, China, Korea, Malaysia and the UAE attract foreign investors due to the availability of high level of quality in their zones.

5.3 Ongoing Trainings

One of the important priorities of any country establishing SEZ should be offering and providing ongoing training and education in order to improve the skills and deepen the knowledge of workforce (Farole, 2011). This practice has been considered as an integral part of doing business and investors are recognizing their importance. In this regard, it can be mentioned that trainings should be provided taking into consideration different needs of different areas and zones. Moreover, trainings should be provided on ongoing basis in order to keep with changing business environment. Furthermore, countries can use certain policies in order to motivate employees to receive training and in certain cases necessary talents can be attracted from other parts of the world.

5.4 Strive to Continuous Innovation and Technology

It is important for the SEZ to keep up with the latest technological trends and innovations in order to sustain their long terms competitiveness. In this regard, it can be achieved through investing in technology upgrading and promoting research and development activities. Moreover, linkages between universities and industries can also be strengthened. Additionally, the activities of business incubators should be developed and talents should be attracted from abroad.

5.5 Establishing Strong Connection with Local Economy

The practices of successful countries show that SEZ activities should be based on linkage with local economy, in this regard, SEZ should be built taking into consideration local competitive advantages and they should use local supplier as a part of their value chain activities. For instance, in China majority of the zones are well linked with local economy (Ganne, 2009). Moreover, Chinese SEZ also encourage foreign investors to build joint ventures with local companies. The Masan Free Zone in South Korea can also be good example which shows the good linkage of SEZ with local economy. Precisely, SEZ in Korea promote the strong linkages between the local firms and investors.

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