Korea KNOWLEDGE SHARING PROGRAM

Knowledge Sharing Program

Development of Navoi Free Industrial Economic Zone in Uzbekistan

April 2010

MINISTRY OF STRATEGY AND FINANCE

KDI Korea Development Institute

Development of Navoi Free Industrial Economic Zone in Uzbekistan

April 2010

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Preface

In the 21st century, knowledge is one of the key factors in determining a country's level of socio-economic development. From this recognition, Knowledge Sharing Program(KSP) was launched in 2004 by the Ministry of Strategy and Finance of the Republic of Korea and the Korea Development Institute(KDI) in an effort to contribute to the socio-economic development in the development partner countries by sharing Korea's unique development experiences. The most distinguishing characteristic of the KSP is that it is a demand-driven, participation-oriented consultation project aiming to tackle development issues from the partner country's perspective and provide policy implications that are not far-reaching but can be practically implemented in the environment of the partner country.

The first Knowledge Sharing Program with Uzbekistan was successfully implemented in 2004 with Center for Effective Economic Policy of the Ministry of Economy on the topic Industrial Development and Export Promotion Policy of Uzbekistan. In 2007, the second Knowledge Sharing Program was conducted with Center for Social and Economic Research of Uzbekistan on the topic, "Feasibility Study on Establishing Special Economic Zones." Upon the successful completion of the feasibility study, the Ministry of Foreign Economic Relations, Investments, and Trade officially requested a follow-up study for the Knowledge Sharing Program in 2009 and a third Knowledge Sharing Program was implemented on the topic, "Development of Navoi Free Industrial Economic Zone." Four specific topics have been studied and policy recommendations have been provided to the government of Uzbekistan: 1) Analysis of Uzbekistan's Export Structure and its Implications on Industrial Composition in Navoi FIEZ; 2) Investment Promotion Strategy and Systemization; 3) Operation System and Policies for the Success of Navoi FIEZ; and 4) An Analysis of Legal Aspects of Navoi FIEZ.

I would like to take this opportunity to express my heartfelt gratitude to Dr. Hyung-gon Jeong, Dr. Doo-gyu Park, Dr. Siwook Lee, and Dr. Shadikhodjaev Sherzod who have participated in the project for their efforts in successfully completing the 2009~2010 KSP for Uzbekistan. I also thank Program Directors Dr. Wonhyuk Lim and Mr. Taihee Lee and Project Coordinator Mr. Jihwan Kim, all of whom are members of the Center for International Development at KDI, for their dedication and contribution to the project. Lastly my special thanks go to the Ministry of Foreign Economic Relations, Investments of the Republic of Uzbekistan for their active support and cooperation.

Upon this occasion of publishing the results of the 2009~2010 KSP for Uzbekistan, I have a strong belief that the results of this year's project will be of great value to the Government of Uzbekistan in establishing and operating the Navoi Free Industrial Economic Zone. I sincerely hope our final research results, including policy recommendations on the selected policy areas could be utilized to help Uzbekistan achieve its goal of becoming the industrial and export hub of the region. The policy recommendations in this report, however, are based on the Korea's development experiences and are solely the opinions and recommendations of the authors.

Oh-Seok Hyun
President
Korea Development Institute

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Introduction

1. Introduction of Knowledge Sharing Program (KSP)

1.1. Program Description

Knowledge Sharing Program(KSP), sponsored by the Ministry of Strategy and Finance (MOSF) of the Republic of Korea, was first launched in 2004 with the aim to assist the socio-economic development of the partner countries by sharing Korea's development experiences. The most distinguishing characteristic of the KSP is that it is a demand-driven, participation-oriented consultation project aiming to tackle the development issues of the partner country and provide policy implications. KSP consists of policy research, policy training and capacity-building activities, and policy consultation, not offering any definitive recipe for economic development but rather, analyzing economic problems of the country from the partner country's perspective and providing practical and tailor-made policy alternatives based on Korea's development experience.

1.2. Objectives of KSP

The objectives of KSP are:

1) Building and enhancing policy management and formulation capacities of government officials and relevant organizations by providing policy research, training and consultation activities while assisting the implementation of policy recommendations;

2) Applying practical and useful Korean development experiences to solve the current policy issues of the partner country by analyzing and putting forth concrete policy recommendations to meet the challenges of economic development;

3) Establishing a cornerstone for the strengthening of bilateral relationship between two countries to achieve to a common prosperity.

1.3. Program Areas

KSP provides policy research, training and consultation to various areas for economic development. The program areas are:

1) Economic Development Strategy
   - Economic Planning System(ex. Five-year development plans), Public-Private Partnership, Feedback Mechanism, Fiscal Planning System, Macroeconomic Forecasting Programs, etc.

2) Industrialization and Export Promotion Policy
   - Development of Manufacturing Industry and Export Promotion Policy for Industrial Diversification, etc.

3) Knowledge-based Economy
   - Promotion of R&D, Innovation Clusters, e-Government System, Development Polices for IT industry, Entrepreneurship, etc.

4) Economic Crisis Management
   - Early Warning System, Macroeconomic Stabilization, Resolution of non-Performing Loans, Structural Reform, etc.

5) Human Resources Development(HRD)
   - Job Creation and Improving Labor Market Competitiveness through HRD, Mid and Long-term HRD Policy, Vocation Training, Social Safety Net, etc.

1.4. Program Cycle

KSP consists of four stages: 1) Demand Identification; 2) Policy Research; 3) Policy Consultation; 4) Program Termination.

During the Demand Identification Stage, a *Demand Survey* is implemented in the partner country with the purpose of identifying development policy priorities, selecting main project topics through interviews and surveys, and identifying the counterpart organization.

During the Policy Research Stage, a *Pilot Study* is conducted in the partner country and relevant sub-topics regarding national policy priorities are defined, important information and economic data, and reports are collected. During this stage, an *Interim Reporting Workshop* is held in Korea where experts and consultants from both countries present and discuss interim findings of the research and feedbacks are collected.

During the Policy Consultation Stage, a *Policy Practitioners' Workshop* is held in Korea after the Interim Reporting Workshop to provide working-level policy practitioners with first-hand experience, and to build and upgrade policy-managing abilities by providing lectures and site visits to relevant Korean ministries and institutions. *Senior Policy Dialogues and Final Reporting Workshop* are held in the partner country where final research results are provided to top policy-makers and relevant experts by recommending policy alternatives.

During the Project Termination Stage, questionnaires and interviews are conducted to assess efficiency and effectiveness of the policy recommendations and to evaluate usefulness, relevancy of the program and to build upon possible follow-up programs.

2. Knowledge Sharing Program with Uzbekistan

The first Knowledge Sharing Program(KSP) with Uzbekistan was implemented in 2004 with the Center for Effective Economic Policy(CEEP) of the Ministry of Economy of Uzbekistan on the topic, 'Industrial Development and Export Promotion Policy of Uzbekistan.' In this report, the Korean experts expressed the necessity of establishing Export Processing Zones(EPZs) or Special Economic Zones(SEZ) as a policy recommendation for sustainable economic growth of Uzbekistan. As a result, 'Feasibility Study on Establishing Special Economic Zones' was carried out as the second Knowledge Sharing Program between the two governments in 2007. In this study, experts from both countries visited six places in different parts of Uzbekistan where SEZs were expected to be built up. Navoi was one of the six places examined and the experts recommended that if the Uzbek government had an intention to develop Navoi as a new air-logistics hub, then prompt and massive investment were vital and cooperation and collaboration with renowned organizations and firms were necessary.

Based on such recommendations, a third KSP between two governments started with Deputy Minister for the Ministry of Foreign Economic Relations, Investments, and Trade (MFERIT), H.E. Tulyaganov's visit to KDI on January 2009. MFERIT sent its Demand Survey Form in February 2009, officially requesting the KSP on the topic, 'Development of Navoi Free Industrial Economic Zone (FIEZ) of Uzbekistan.' Based on the importance of the suggested topic by the Uzbek government and the strengthening of economic relations between two countries, MOSF and KDI selected Uzbekistan as its development partner country for KSP in 2009.

In order to carry out a successful KSP with MFERIT, KDI recruited experts in the relevant field and composed the Korean experts team. The experts involved in the program are: Dr. Hyung-gon Jeong of Korea Institute for International Economic Policy; Dr. Doo-gyu Park of Korea Trade-Investment Promotion Agency; Dr. Siwook Lee of Korea Development Institute; and Dr. Shadikhodjaev Sherzod of Korea Institute for International Economic Policy.

In April 2009, the Korean experts team, led by H.E. Jung Taik Hyun, former Senior Secretary to the President for Economic Affairs, visited Tashkent and Navoi for a pilot study. The Korean delegation met with high-level government officials including H.E. Azimov, First Deputy Prime Minister, H.E. Saidova, First Deputy Minister of Economy, and H.E. Tulyaganov, Deputy Minister of MFERIT and experts and discussed policy priorities regarding the establishment of the Navoi FIEZ.

In August 2009, H.E. Tulyaganov, Deputy Minister of MFERIT and the Uzbek delegation of twenty experts involved in the establishment of the Navoi FIEZ visited Korea for twelve days to participate in an Interim Reporting & Policy Practitioners' Workshop. Lectures on Korea's economic development experience, Korea's FDI strategy, FDI negotiation tactics were provided to the participants. The Interim Reporting Workshop was held in KDI and the experts from both countries engaged in an active discussion on the interim findings of the report presented by the Korean experts. In addition, the delegates visited KICOX to hear about lessons on Korea's Industrial zones. The delegates also visited the MOSF, Guro Digital Complex, Masan Free Trade Zone, POSCO, Hyundai, Daeduk Innopolis, Korean Air, and Incheon Free Economic Zone.

From October to November, a survey was conducted to 130 different firms in Korea that visited the Navoi FIEZ at least once in 2009. The survey asked the willingness of the firms to invest in the Navoi FIEZ, types of investment, reasons for the investment, industrial facilities needed and pros and cons of investing in the Navoi FIEZ, etc. A total of 59 firms responded to the survey and the results of the survey are incorporated in each of the following chapters.

As the final stage of the KSP with Uzbekistan, the Senior Policy Dialogue and Final Reporting Workshop were held in Tashkent on January 2010. For the Senior Policy Dialogue, the Korean delegation led by H.E. Jung Taik Hyun, former Senior Secretary to the President for Economic Affairs met with H.E. Azimov, First Deputy Prime Minister and H.E. Elyor Ganiev, Deputy Prime Minister to deliver final research results and recommend policy implications for the success of the Navoi FIEZ. The Final Reporting Workshop was held in Navoi Hall at the International Business Center. High-rank government officials, the Korean ambassador to Uzbekistan, and about 70 relevant experts and people involved in the establishment of the Navoi FIEZ participated in the Workshop to listen and discuss about the final findings of the program and policy implications for Navoi FIEZ.

The research results and policy recommendations on four sub-topics under the main topic, 'Development of the Navoi FIEZ' are provided in four chapters accordingly. The sub-topics are:

1) Analysis of Uzbekistan's Export Structure and its Implications on Industrial Composition in Navoi FIEZ;

2) Investment Promotion Strategy and Systemization;

3) Operation System and Policies for the Success of Navoi FIEZ;

4) An Analysis of the Legal Aspect of Navoi FIEZ.

Chapter 01

Analysis of Uzbekistan's Export Structure and its Implications on Industrial Composition in Navoi FIEZ

1_ Motivation
2_ Export Diversification, Growth and FIEZ: Concepts and Evidence
3_ Current Export Structure of Uzbekistan
4_ Priority Production Direction of the Navoi FIEZ
5_ Summaries and Conclusion

Chapter 01

Analysis of Uzbekistan's Export Structure and its Implications on Industrial Composition in Navoi FIEZ

Siwook Lee (Korea Development Institute)

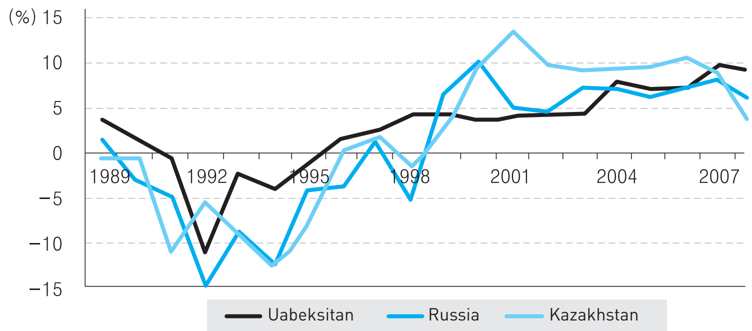
1. Motivation

Uzbekistan has adopted an evolutionary approach to transition into a market economy since the collapse of the Soviet Union in the early 1990s, which contributed to a somewhat less painful transition process, compared to most of the other CIS countries. Coupled with a number of successful anti-crisis programs[1], this approach also helped to maintain a strong macroeconomic performance in recent years.

In fact, under swirl of the global economic crisis, the Uzbek economy has maintained not only economic stability but also a high level of economic growth, with 9.0 percent and 8.1 percent of annual growth rates in 2008 and 2009, respectively. Investments grew by 33 percent in 2009, while real income for Uzbekistan grew 26.5 percent.

Figure 1-1 | **Comparison of the GDP Growth Rates**

(Unit: Annual, %)



Source : EBRD database

Despite the recent strong economic performance, there is still little doubt that Uzbekistan needs to diversify and upgrade the industrial structure towards more technology- and capital-intensive sectors, in order to maintain the aforementioned stable economic growth for a longer term. Rodrik(2007) argues that economic development requires industrial diversification, aiming at enhancing productive capacities over an increasing range of manufacturing sectors. Recent cross-country analyses generally suggest that countries tend to grow faster as they promote exports of more sophisticated manufacturing products. Therefore, vertical diversification through export promotion is a very important element for the long-term economic growth.

In case of Uzbekistan, agricultural and mineral sectors remain as important sectors of the economy, although there has been a significant reduction in their shares in GDP over time. For example, the agricultural sector accounts for 23.4% of GDP in 2008, which is much higher than the world average at around 3%.

Recognizing the imminent need for industrial diversification, the Uzbek government recently established a Free Industrial Economic Zone(FIEZ, hereafter) at the Navoi region. In recent years, we have witnessed a remarkable proliferation of FIEZs all around the world. According to the International Labor Office(ILO, 2007), the number of FIEZs has increased drastically from 79 in 25 countries in 1975 to around 3,500 zones in 130 countries in 2006.[2]

Export Processing Zones(hereafter EPZs) have been often introduced as part of policy instruments to promote exports and ultimately to contribute to sustainable economic growth. Indeed, these zones could be an efficient way of generating employment, earning foreign exchange to finance domestic investment, and adopting technology developed elsewhere. Radelet(1999) argues that no country has ever been able to rapidly expand manufacturing exports without a platform like FIEZ.

At the same time, however, EPZs involve large investments in publicly supplied infrastructure and various tax concessions to foreign investors, and thus this raises the question of whether such investments are worthwhile or not. Historically, only a few FIEZs, mostly those of East Asian countries, turned into a success.

Hence, while an FIEZ is widely recognized as an effective policy option for economic development, especially for a country having relatively weak competitiveness in high value-added sectors, its success is not automatically guaranteed. Under growing competition in attracting foreign investment across countries in recent years, it is getting even harder to do so.

1. In December 2008, the Uzbek government announced a number of anti-crisis programs to support exporters, domestic producers and SMEs, while also aiming to promote overall energy efficiency.
2. Free Export Zones(FEZ), Free Trade Zones(FTZ), Export Processing Zones(EPZ), Special Economic Zones(SEZ) and Industrial Free Zones(IFZ) refer to similar concepts with FIEZs although there is some variation for policy prescriptions and objectives.

It is more likely than before that they may end up with expending too much, possibly total costs being surpassed potential benefits from implementing an FIEZ policy.

Historical evidence suggests that the success of an FIEZ policy critically depends on how well it is designed and implemented, especially in terms of priority production direction within the FIEZ region, administrative structure, incentive packages given to foreign investors, other institutional and legal provisions, etc. Among these issues, this chapter mainly focuses on investigating possible priority production direction in terms of industrial composition within the Navoi FIEZ, while leaving the other issues in the subsequent chapters in this volume.

Envisioning for production direction with the FIEZ a priori, aiming at stimulating future economic development for the overall economy, is not an easy task. Furthermore, there is no unified framework to do so. In this chapter, we evaluate and suggest possible production direction for the Navoi FIEZ, basing on the following analyses: First, we extensively analyze the current trade structure of Uzbekistan and select industrial sectors that, even though currently underdeveloped, have a great export potential. Specifically, we employ the Commodity Complementarity Index approach to examine which the Uzbek exporting products match well with its trading partners' import demand.

Second, given that one important advantage of the Navoi FIEZ over other FIEZs in the region is the air transport-logistic potential, we investigate a set of exporting products that could take advantage of such air transport-logistics, including electric/electronic parts and components, semi-processed machinery and equipment, textile, etc. Third, we also examine specific demand for potential investors in terms of their production direction within the Navoi FIEZ, using surveys targeted to Korean firms that visited Navoi.

The rest of the paper proceeds as follows: Section 2 introduces some basic concepts and empirical evidence on export diversification and the FIEZ. Then, in Section 1-3 we investigate the Uzbekistan's current export structure. Analytic focus here is on the extent of export diversification and the patterns of external trade. And Section 1-4 presents the analytic results regarding possible production direction of the Navoi FIEZ. Finally, Section 1-5 summarizes the findings and policy suggestions in this paper.

2. Export Diversification, Growth and FIEZ: Concepts and Evidence[3]

2.1. Export Diversification and Economic Growth

3. This section contains a revised and extended discussion from Lee (2009).

Export diversification can be defined as a dynamic process of modifying an economy's pattern of specialization to expand the variety of exportable goods. The literature on economic growth has recently redrawn a great attention to the role of export diversification on the long-term structural change and economic growth.

Apparently, the traditional trade theory provides no clear role for export diversification. According to the theory of comparative advantage, the gains from trade follow from allowing an economy to specialize in sectors in which its productive capabilities in comparison to those of its trading partners are relatively better than those of the other sectors. Hence, more specialization in these sectors leads to a greater extent of efficiency.

On the other hand, Hausman and Klinger(2006) recently argue that economic growth may be generally not driven by comparative advantage, but by countries' diversification of their investments into new activities. They regard export diversification as an investment in learning which products can be profitably sold in the external markets. If they succeed in exporting new goods, the gains will be socialized through information spillovers for the overall economy. On the other hand, however, all the losses end up being privates, if they fail. Consequently, under-provision of investment into new activities, a typical externality issue arises due to uncertainties that they face when they try to export new goods. Hence, Hausman and Klinger(2006) suggest that the government should play an active role in promoting favorable business conditions and in providing the proper incentives for firms to invest in new activities.

As a matter of fact, countries can benefit from diversifying their export portfolio. First of all, export diversification brings into the domestic economy externalities such as technological spillovers, which is an important determinant for long-run sustainable growth. New endogenous growth literature suggests that every new export variety represents an innovation which is preceded by creative effort and requires knowledge in its production. Agosin(2007) emphasizes the importance of export diversification as the key source of technological learning for countries that are far from the world technological frontier.

Vertical diversification, in particular, can play an important role not only for economic stability but also for the long-term viability for the economy. The developing countries can benefit from greater potential for sustained technological learning and more spillover benefits to other activities if they move towards producing higher value-added products.

A diversification policy aiming to enhance vertical diversification may require more advanced technology, skills and initial capital investment than horizontal counterpart does. Vertical diversification is usually linked with higher learning possibilities that, in turn, may produce greater dynamic externalities than that for horizontal diversification.

Furthermore, export diversification into new industries provides a stimulus for the creation of other new industries and/or expansion of existing sectors, through industrial backward and forward linkages. This is particularly the case if diversification takes place through adding new exports to the existing export basket. The extent to which these linkages of export sectors with the other sectors through export diversification largely depend upon specific patterns of export diversification, input-output coefficients of the production under given production technology as well as the domestic utilization of the commodity. Export diversification among raw primary products and that among processed manufacturing goods would produce quite different impacts on the domestic economy.

Backward linkages exist when increased production by downstream firms provides positive pecuniary externalities to upstream firms. An increase in production by downstream firms generates an increase in demand for upstream firms. In our context, backward linkages from export diversification occur when export-oriented companies try to produce new commodities and purchase their intermediate inputs and/or capital goods from the domestic economy. This may not only help the other sectors in the domestic economy to expand, but also act as an important stimulus to create new upstream sectors.

On the other hand, forward linkages exist when increased production by upstream firms provides positive pecuniary externalities to downstream firms. These are "forward" linkages because the effect of a change is transmitted to firms further along in the sequence of production. Since exports are by definition to serve foreign markets, there may be little scope

Table 1-1 | Goals and Types of Export Diversification

	Stability-oriented		Growth-oriented		
	Based on Existing Commodities	Add New Commodities	Based on Existing Commodities	Add New Commodities	
Horizontal Diversification	Adjust export shares based on covariation of export earnings from individual commodities	Add new commodities based on covariation of export earnings from individual commodities	Adjust export shares based on growth rates of export earnings from individual commodities	Add new commodities based on growth rates of world prices	Add new commodities based on market niche
Vertical Diversification	Adjust export shares based on a commodity's ability to be marketed in raw or processed forms in both international and domestic markets.	Add new commodities based on their flexibility to be marketed in raw or processed forms in both international and domestic markets.	Introduce or expand value-added activities and import substitution	Choose new commodities based on value-added and import substitution potential	

Source : Ali et al. (1991)

for forward linkages from export diversification to the other sectors in an economy. In reality, however, commodities are usually sold in both international and domestic markets. Thus depending on demand structure of these commodities, forward linkages from diversification could take place. In turn, if export diversification brings income growth into the domestic economy, it will increase domestic demand for a wider variety of products.

Export diversification can take a form either of market diversification or of product diversification. Market diversification refers to geographical expansion for export destination. On the other hand, product diversification takes place by changing the shares of commodities in the existing export mix, or by adding new commodities in the export mix. Product diversification can be further classified into horizontal and vertical ones; the former is to increase the variety of export sectors/products with similar levels of technological sophistication; and the latter is to expand exports by adding higher value-added exports.

As discussed so far, export diversification contributes to economic growth in various channels. Most of the empirical studies so far also indicate the positive correlation between diversification and economic growth. For example, Lederman and Maloney(2007) find that concentration of export revenues reduces economic growth by hampering productivity enhancement. Similarly, De Ferranti et al.(2002) show that 1 percent increase in export concentration is associated with a 0.5 percent decline in GDP per capita growth. Al-Marhubi(2000), de Pineres and Ferrantino(2000) and Herzer and Nowak-Lehman(2006) also find support for a diversification-led growth hypothesis.

Recently, Carrère et al.(2007) and Amurgo-Pachero and Pierola(2008) find that patterns of export diversification differ depending on the specific stage of economic development. Low- and middle-income countries diversify mostly along the extensive margin(i.e., growth of exports by adding new commodities) whereas high-income countries diversify along the intensive margin(i.e., growth of exports in goods that are already being exported) and ultimately re-concentrate their exports towards fewer products. The turning point is around 20,000~22,000 dollars per capita at purchasing power parity. Hesse(2008) interprets such stylized empirical fact in a way that the positive effect of export diversification on economic growth usually takes place in case of developing countries, in contrast to the most developed countries that perform better with export specialization.

On the other hand, recent evidence proposed by Hidalgo et al.(2007) convincingly suggests that some patterns of export diversification are more conducive than others to promote industrial upgrading. Using international trade data, Hidalgo et al.(2007) show that the way countries develop comparative advantage is far from random, and the type of product that a country exports matter for subsequent economic performance. Some developing countries produce in the periphery of the product space with few opportunities for diversification, whereas others have developed capabilities easily deployable in a wide range of products creating a path to convergence.

Finally, Shepherd(2008) shows that export costs, tariff, and transport costs are detrimental to market diversification for exports, while the market size and development level for the exporting country impact market diversification positively. Specifically, he suggests that a 10% reduction in export-related costs increases the number of export destination by around 5~6%. Shepherd(2008) also finds that the negative impacts of export costs on geographical diversification are bigger in poorer countries than their counterparts. In addition, export costs and transport costs have stronger impacts in more differentiated sectors. Similarly Amurgo-Pachero and Pierola(2008) find that reducing trade costs has a significant impact in the determination of the intensive margin and the changes in the extensive margin.

2.2. FIEZ and Economic Growth: Basic Concepts

While there exists a wide variety of definitions of the FIEZ policy, this paper adopts the one recently suggested by Engman et al.(2007): a government policy to promote exports of goods and/or services by offering a more competitive business environment through provision of specials incentives including in particular, tariff exemptions to inputs either in geographically defined area or through a specification process.

This definition comprises quite broad types of FIEZs, covering not only traditional manufacturing-oriented “fence-in” zones but also single factory programs(e.g. Maquiladoras in Mexico) and service-oriented zones(e.g. Information Processing Zones or Financial Service Zones).

<Table 1-2> classifies different types of FIEZs and presents their characteristics(ILO, 2003). The most traditional FIEZs are Industrial Free Zones or Exporting Processing Zones, of which the main objective is to nurture export sectors, mostly those of light industries such as textiles and electronics. However, recently some other types of EPZs like high tech and science parks, finance zones and warehouse centers emerged.

As aforementioned, the number of FIEZs around the world has rapidly increased in recent years. Among around 3,500 FIEZs in 2006, more than 900 zones were located in Asia, followed by the United States(713), Latin America(448), transitional economies(400) and so on. In 2006, around 66 million people were working within these FIEZs and the zones in China had the lion’s share - over 40 million workers. <Table 1-3> presents some examples of FIEZs located in developing countries.

Table 1-2 | Types of Zones: ILO's Evolutionary Typology

	Trade	Manufacturing			Service		
	Free port	Special economic zone	Industrial free zone /Exporting processing zone	Enterprise zone	Information processing zone	Financial service zone	Commercial free zone
Physical Characteristics	Entire city or jurisdiction	Entire province region or municipality	Enclave or industrial park	Entire or part of city	Part of city or zone	Entire city or "zone within zone"	Warehouse area often near port or airport
Economic Objectives	Development of trading centre and diversified economic base	Deregulation; private sector investment in restricted area	Development of export industry	Development of SMEs in depressed areas	Development of information processing center	Development of off-shore banking, insur-ance, securities hub	Facilitation of trade and imports
Duty free goods allowed	All goods for use in trade, industry, consumption	Selective basis	Capital equipment an production inputs	No	Capital equipment	Varies	All goods for storage and re-export of imports
Typical activities	Trade, service, industry, banking, etc.	All types of industry and services	Light industry and Manufacturing	All	Data processing, software dev, Etc	Financial services	Warehousing, packaging, distribution, trans-shipment
Incentives - taxation - customs' duties - labor laws - other	Simple business start-up: min. tax & regulatory restraints; waivers to termination of employment & overtime; free repatriation of capital, profits & dividends; preferential interest rates.	Reduced business taxes; liberalized labor codes; reduced foreign exchange controls. no specific advantages; trade unions discouraged	Profits tax abatement and regulatory relief; exemption from for. Exchange controls; free repatriation of profits; Trade union freedom restricted despite the EPZs are required to respect national employment regulations; max 15 years exemptions on all taxes	Zoning relief; simplified business registration; local tax abatement; reduction of licensing requirements; prohibited trade unions; government mandated liberal on hiring and firing	De-monopolization and regulation of telecoms; access to market- priced INTELSAT service; specific authority manages labor relations; Trade union freedom restricted	Tax relief; strict confidentiality; deregulation of currency exchange & capital movements; free repatriation of profits	Exemption from import quotas; reinvested profits wholly tax-free
Domestic sales	Shipment outside possible with payment of full duty	Highly restricted	Limited to small portion of production			Limited to small portion of production	Unlimited, upon payment of full duty
Other features	Additional incentives & streamlined procedures	Developed by socialist countries	May be extended to	single-factory sites			
Typical examples	Hong-Kong, Macao, Singapore, Bahamas, Bataan, Labuan	China (southern provinces, incl. Hainan, Shenzhen)	Ireland, Ch. Taipei, Malaysia, Dom. Rep., Mauritius, Kenya, Hungary	Indonesia, Senegal	Bangalore, Caribbean	Bahrain, Dubai, Caribbean, Turkey, Cayman	Jebel ali, Colon, Mauritius, Iran

Source: ILO(2003) edited by Secretariat

Table 1-3 | Examples of FIEZs in Developing Countries

	No. of FIEZs	Employment (2005~06)	Investing countries	Sectors
China	15 EPZ 56 ETDZ 12 FTZ, etc.	40 million	US, Germany, France, Japan, Hong Kong, Taiwan, Korea, etc.	Electronics, electric equipment, petrochemical, textile, food, car, etc
India	8 SEZ	100,650		High-tech, jewelry, pharmaceutical Leather, textile, food processing
Czech Rep.	81 IZ	487,000		Automotive industries, ICT, food processing, etc
Ukraine	17 EPZ 9 PDA			Agriculture, mining, textile, wood, etc
Hungary	160 IP		Netherlands, US, Germany, Japan, Korea, etc.	Warehousing, automotive/tires, electronics services, etc
Bangladesh	8 EPZ, etc.		China, US, UK, India, Japan, Korea, etc.	Gas & oil, leather, textile, food processing, pharmaceutical, etc.
Iran	3 FTIZ 18 SEZ		Germany, France, UAE, Turkey	Textile, shoes, leather, packing

Source : ILO(2007)

Motivations for implementing FIEZ policies differ across countries. Some countries establish FIEZs to ease financial and technological constraints by attracting foreign investors, especially at the early stage of development. Resource-abundant economies often use FIEZs as a policy tool for diversifying the industrial structure and creating new employment opportunities. Resource sectors such as oil-extracting industry usually account for a large share in exports and/or government revenues in these countries, but they tend to offer little employment opportunities. Finally, for most of the developing countries, FIEZs are an efficient way to bypass poor business environment by creating an enclave immune to the weak institutional system and administrative capacity prevailed elsewhere in the economy.

Engman et al.(2007) recently classified different roles of FIEZs in economic development as the following: First, FIEZs can serve as an enclave to achieve specific policy objectives, such as raising foreign exchange earnings, adopting advanced technology, creating new employment opportunities, etc. Nowadays many developing countries make a great effort to attract FDI, but they often confront difficulties in doing so, mainly due to weakness in administrative and infrastructural capacity. In this case, FIEZs allow these countries to focus their resources on a limited area, to achieve certain policy objectives.

Second, FIEZs can be a steppingstone on the path to nationwide trade liberalization. Even though integrating local economies into world economic system is an ultimate goal, it may require time and adequate planning to maximize benefits from such a move. Therefore, FIEZs can be used as a test bed for countrywide trade liberalization.

Third, Engman et al.(2007) argue that the FIEZ policy can be a regional development tool to promote investment in disadvantaged areas, although it usually comes from political and social considerations rather than economic and technical ones.

2.3. Case Study: the Masan Export Processing Zone

As aforementioned, while an FIEZ is widely recognized as an effective policy option for economic development, especially for a country having relatively weak competitiveness in high value-added sectors, historically only a few FIEZs, mostly those of East Asian countries, turned into success. FIEZ firms in the world often do not form links to the domestic economy, in most cases purchasing almost all their inputs from abroad. Consequently FIEZs remain as a mere enclave, which produces little externalities to the rest of the economy.

In this context, this section briefly illustrates the case of the Masan Export Processing Zone (Masan EPZ hereafter) in Korea, which is known as a rare example of success in establishing close linkage between EPZs and the rest of the economy. The Masan EPZ greatly contributed to subsequent industrial upgrading, especially the electronics industry in the Korean economy.

2.3.1. Brief History of the Korean EPZ Policy

Korea had actively pursued an export-oriented strategy since 1960s. At the early stage of economic development, exports were recognized as the main conduit of foreign exchange receipts, which in turn could be used for purchasing intermediate goods for domestic production and exports. EPZ policy was introduced in Korea in the early 1970s as part of such export-oriented economic development strategy.

The idea of establishing EPZs in Korea was initially inspired by the Kaoshung EPZ in the late 1960s(Lee, 2008). After having visited the Kaoshung EPZ in Taiwan, the members of the Federation of Korean Industries(FKI), an association of Korean large conglomerates, suggested to construct EPZs at the monthly 'export situation room' meeting.[4]

After a review process, the Korean government established its first EPZ at Masan in 1970, shortly followed by the second EPZ in Iksan in 1973. The government enacted the Free Export

4. The Korean President presided over this meeting with high-ranking government officials and the leaders of the private sector since 1965. The basic purpose of this meeting was to regularly review export performance and to remove any of the bottlenecks based on suggestions from the private sector at the meetings.

Zone Establishment Act, which enabled designation of these two EPZs. The government provided very favorable incentives and business environments to foreign investors within the EPZs, which we discuss in more detail later in this paper.

The Masan EPZ was quite successful, contributed not only to the development and employment creation of the region but also to those of the rest of the economy through backward linkages. The Masan EPZ reached its peak in the early 1980s after remained stagnant, due to saturation in space and rising labor costs(Engman et al., 2007).

Lee(2008) summarizes the history of the Korean EPZs into three stages of development. At the first stage, the firms in the EPZs specialized in labor-intensive industries without much linkage with the rest of the economy. The majority of the EPZ workers were female. The major motivations for foreign firms to locate in the EPZs were favorable incentives offered by the government and low labor costs.

Growing linkage between EPZs and the rest of the economy characterizes the second stage of EPZ development in Korea. From the mid-1970s, the productive space in the Masan site was getting saturated, which resulted in increasing the need for outsourcing of some semi-processed products outside the EPZs. The EPZ administrative authority dealt with this situation by amending the EPZ Law, allowing foreign firms to purchase some processed intermediate goods from the domestic economy.[5] This created a close connection between EPZs and the domestic economy and led for the firms in EPZ to specialize in more technology-intensive processes.

At the third stage of development, the investment share of the Korean firms in the EPZs increased and processes themselves became more technology-intensive. While exports kept on growing, the employment in the zones significantly declined at this stage. In the mid-1980s, monthly wage in the Korean manufacturing sectors reached at the level of almost over three times higher than other countries with EPZs, such as Malaysia and Thailand. Therefore, labor-intensive industries were no longer suitable as the target for production in EPZs.

In the early 2000s, the existing Free Export Zone Establishment Act was replaced by the Free Trade Zone Designation Act, as special duty free zones began to incorporate logistical as well as manufacturing functions. Accordingly, the focus of activity in free trade zones shifted from manufacturing to areas such as trading, information processing and logistics, which in turn entails various operations such as storage, transportation, cargo-handling packaging and marketing.

5. The partial processing outside the EPZs was required not to exceed 60% of the total manufacturing process, calculated in terms of production costs. The goods processed or produced by the outzone activity were components or intermediate products for production processes finalized in the EPZs(Healey and Lutkenhorst, 1989).

In accordance with this shift, the titles of the zones were changed from “free export zones” to “free trade zones.” Gunsan and Daebul in Jeolla Province were designated as free trade zones and the existing zone at Masan underwent a massive expansion.

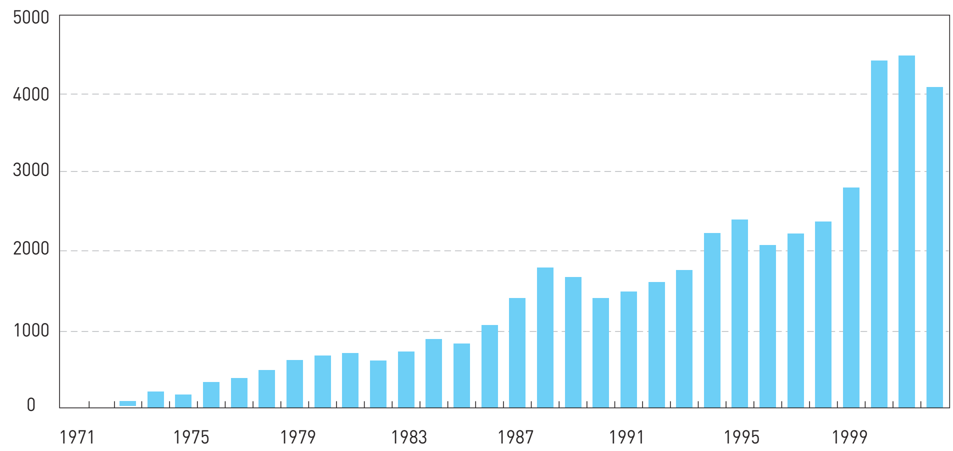
2.3.2. The Masan EPZ: Promoting Backward Linkage

Following its designation as a Free Export Zone in 1970, Masan has enjoyed a phenomenal success. Masan accounts for only 0.2 percent of the total area dedicated to all Korean industrial complexes, but it successfully posited itself as a center of processing trade.

As depicted in [Figure 1-2], exports generated in the Masan EPZ has been ever growing from 0.9 million dollars in 1971 to 4.5 billion dollars in 2001. Exports in 2001 from this area amounted to 3.0 percent of total Korean exports in that year. In 1970s, the export growth rate from the zone exceeded that of national exports. Electronics and electrical industries accounted for the majority of total exports, around 70% and so on, and then precision tools and instruments. Major export destinations were Japans and the United States.

Figure 1-2 | Export Growth in the Masan EPZ

(Unit: US million Dollars)

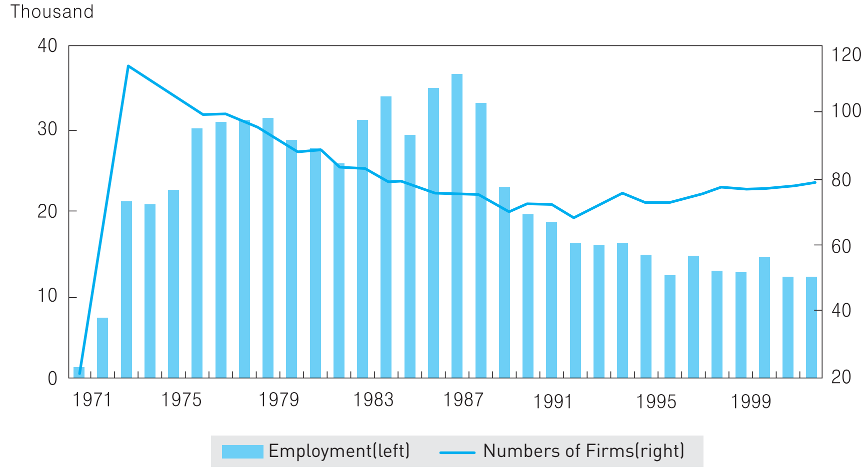


Source : Administration Agency of Masan Free Trade Zone(http://www.ftz.go.kr)

In terms of employment, the Masan EPZ had steadily expanded until reaching its peak at 36,411 workers in 1987. Furthermore, employment composition changed in a way that the proportion of women in the area decreased from over 90 percent in 1971 to 70 percent in 1990. This change reflects the fact that production in the EPZ gradually shifted from unskilled labor-intensive industries into skilled labor-intensive ones.

As shown in [Figure 1-3], the number of firms increased substantially in the years immediately after its establishment, which implies that the Masan EPZ kept on being fully utilized.

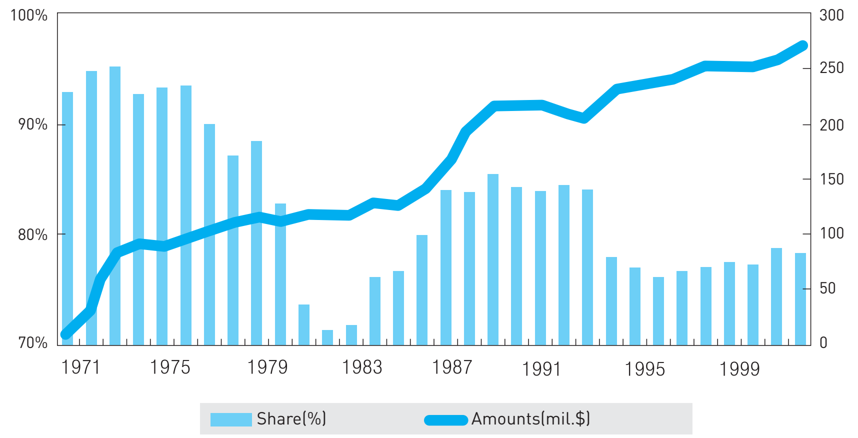
Figure 1-3 | Employment and Number of Operating Firms in the Masan EPZ



Source : Administration Agency of Masan Free Trade Zone(http://www.ftz.go.kr)

Foreign investments in the Masan EPZ had been ever increasing from 5 million dollars in 1971 to 258 million dollars in 2001. Meanwhile, there had been a significant ownership change since the establishment of the EPZ. In early 1970s, foreign investment accounted for over 70% of total investment in the zone. But the share of foreign investment declined since then and reached the level of less than 80% in 2000s.

Figure 1-4 | Foreign Investment in the Masan EPZ



Source : Administration Agency of Masan Free Trade Zone(http://www.ftz.go.kr)

<Table 1-4> compares economic effects anticipated at the planning stage and those realized in 10 and 30 years later from its establishment. As shown in the table, the Masan EPZ over-

performed in terms of FDI inflows and export growth, while employment creation was somewhat lower than expected.

Table 1-4 | Economic Performance of the Masan EPZ

	Expected effect at planning stage(A)	Ex post effect (B)			
	1970	1980	(B/A)	2000	(B/A)
Foreign Investment (mil. $)	25.0	93.1	3.7	193.7	7.7
Exports (mil. $)	132.5	628.1	4.7	4,442.1	33.5
Employment Creation (1000)	32.3	28.5	0.9	14.4	0.4

Source : Administration Agency of Masan Free Trade Zone(http://www.ftz.go.kr)

As aforementioned, one distinct feature of the Masan EPZ was growing interdependence between the EPZ and the rest of the economy. When the zone started operations in 1971, domestic firms supplied only 3 percent of materials and intermediate goods to firms in the zone. Four years later, that percentage had increased to 25 percent and eventually reached 44 percent. Consequently, the domestic value added steadily increased from 28 percent in 1971 to 52 percent in 1979(Engman et al., 2007). In 1988, a total of 56 of the 73 zone firms had engaged 525 domestic firms for outsourcing process. This is quite in contrast with some EPZs in other countries.

Table 1-5 | Share of Local Raw Materials used for Production in EPZs

Country	EPZ	Local Sourcing of Inputs				Subcontracting
		Year	Share	Year	Share	
Malaysia	Penang	1976	0.2%	1987	17.7%	Very limited
Korea	Masan	1971	3.3%	1985	32.3%	Very active
Taiwan	Total	1967	2.1%	1979	28.3%	
SriLank	Total	1979	0.0%	1991	3.8%	Non-existent

Source : Kusago and Tzannatos(1998)

More importantly, the close liaison between EPZ and the rest of the economy created favorable environment for technological transfer into the domestic economy. Technology transfer may occur when there is a transfer of personnel between a foreign company and a domestic company. Efforts by local authorities to promote personnel exchanges, supporting training efforts and providing technical assistance to potential suppliers have been important.(Jenkins et al., 1998) An estimated 3000 to 4000 persons received specialized training in the zone and abroad(especially Japan), half of which eventually left the zone to work in local electronic Korean firms. For the periods of 1973~1995, a total of 10 thousand workers received training abroad and more than 5 thousand foreign engineers were invited into the Masan EPZ.

In addition, the EPZ in Masan contributed to regional development. Between 1969 - when the EPZ was constructed - and 1974, the population of the city of Masan increased from 179,000 to more than 360,000. Prior to 1969 the population of the city had been growing at an annual average rate of only 2.2 percent. In the five years following the opening of the EPZ, population grew by nearly 16 percent a year.

Last but not least, the Masan EPZ has been a crucial factor to nurture the Korean electronics industry, especially the semiconductor sector, at its early stage of development in the periods of 1970~80s. Korea had started to assemble transistors in the mide - 1960s through the sub-contracting relationship with multinational corporations that intended to take advantage of cheap labor in Korea. Then many Japanese electronics firms established their subsidiaries in the Masan EPZ. These multinational firms introduced the technology of wafer processing and IC production to Korea. In this process, the Masan EPZ emerged as the early-stage industrial cluster for electronics sector. Within the Masan EPZs, electric and electronics accounted for about a half of investment in the late 1970s, and more than 70 percent in 2000s, as illustrated in <Table 1-6>. Likewise, the Masan EPZ case indicates the significant role of EPZs in nurturing infant industries for further industrial development.

Table 1-6 | Sectoral Composition of the Masan EPZ

(2004, US mil. $)

	Firms		Exports		Investments	
	Number	Share(%)	Amount	Share(%)	Amount	Share(%)
Electrics & Electronics	26	34.2	3,159	95.6	186	70.7
Precision machinery	15	19.7	50	1.5	36	13.8
Metal	9	11.8	43	1.3	12	4.4
Footwear/textiles	6	7.9	9	0.3	4	1.5
General machinery	6	7.9	27	0.8	11	4.1
Non-metal	4	5.3	5	0.2	2	0.8
Others	10	13.2	13	0.4	12	4.7
Total	76	100.0	3,305	100.0	264	100.0

Source : Administration Agency of Masan Free Trade Zone(http://www.ftz.go.kr)

As far as policy concerns, there are a number of reasons why the Masan EPZ was highly successful. First, the EPZ administration actively promoted inter-linkage between local industries and sub-contractors in the EPZ. EPZ firms in Korea have linked with the local economy through subcontracting and domestic purchases and have performed positively in generating net exports and spillover effects. In doing so, the zone authority allowed preferential access to intermediate goods and raw materials to local companies supplying EPZ firms. In addition, the zone administration provided technical assistance to sub-contracting firms. Foreign Direct Investment in an EPZ also had a “demonstration effect” by serving as a role model for replication by local entrepreneur(Engman et al. 2007).

Engman et al. (2007) convincingly argue that granting ‘equal footing’ to local suppliers of capital and intermediate goods and the usage of subcontracting mechanisms from zone enterprises to local producers were among the most effective measures. These methods, combined with overall trade and investment reforms, fostered successful export oriented zones and backward/forward linkages from the EPZ and the local economy.

Second, a feature of the EPZ of great importance is the existence of a centralized administrative office with various autonomous decision powers. At the same time, the local authority kept a close relationship with the central government in implementing the EPZ policy. In some other countries, a right to issue licenses and permissions to business entities within the EPZs is often granted to the regional government. In this case, there may be a great possibility that the regional interest may be involved in the process of EPZ implementation. Things get worse if multiple EPZs co-exist within an economy and if each one is managed by the regional government, because this may result in the redundant FDI promotion and the wasteful competition among these EPZs.

Third, geographic factors as well as infrastructure played an important role for successful implementation of the EPZ policy. For example, proximity to the Japanese ports, a major export destination, substantially reduced transport costs. Furthermore, the existence of a highway directly to Pusan and the harbor facilities prior to the establishment also reduced initial investment for EPZ.

Last but not least, policy consistency toward export-oriented strategy maintained by the Korean government also contributed to the success of the Masan EPZ. For example, in order to ensure cost competitiveness of exporters, the government underwent periodic devaluation thereafter. And the export bureaucracy functioned efficiently enough to ensure that the incentives and the systems ensuring access to them could be adjusted thorough continuing evaluation by the government in response to the changing environment at home and abroad (Ahn and Kim, 1997).

In sum, we can conclude that the Masan EPZ is a successful case that well-structured policies made EPZ treatment gradually extended to firms located outside the zone, especially for the electronics industry.

3. Current Export Structure of Uzbekistan

3.1. Overview

<Table 1-7> presents major exporting sectors of Uzbekistan as of 2006, classified by the HS(Harmonized Systems) 2-digit codes of product classification.[6] As shown in the table, cotton

is the largest exporting sector, which accounts for around one-fifth of total exports and around 60 percent of total agricultural exports. In fact, Uzbekistan is the 6th largest cotton producer in the world, accounting for 5 percent of the world's total production, after China(29 percent), India(21 percent), the U.S.(16 percent), Pakistan(7 percent) and Brazil(6 percent) as of 2007-08. The second largest exporting sector is energy and petroleum products, followed by transportation equipment(HS 87), Copper(HS 74), and edible fruit et al.(HS 08).

One distinct characteristic here is that exports are quite concentrated in terms of export destination. <Table 1-7> shows that the destinations of the major exports are quite concentrated on few countries, mostly the CIS economies. For example, transportation equipment(HS 87) is mostly destined to Russia(85.1 percent of total exports). This is quite a common characteristic of the CIS countries, largely due to historical heritage of the Soviet Union and geographically landlocked feature of the economies.

Table 1-7 | Top 12 Exporting Products of Uzbekistan(2006)

HS code	Industry	Share in total exports	Share of top 3 destinations	Net trade (US mil $)
52	Cotton	20.2%	China(49.9%)/Russia(13.1%) /Turkey(12.2%)	990
27	Mineral fuels, oils, distillation products, etc	17.2%	Ukraine(36.7%)/Romania(17.9%) /Kazakhstan(15.3%)	701
99	Commodities not elsewhere specified	12.2%	Poland(99.9%)/U.S.(0.1%)/Ukraine(0.1%)	562
87	Vehicles other than railway, tramway	10.2%	Russia(85.1%)/Ukraine(8.1%) /Kazakhstan(4.9%)	-120
74	Copper and articles thereof	8.0%	Turkey(59.3%)/Italy(21.4%) /Ukraine(8.1%)	388
08	Edible fruit, nuts, peel of citrus fruit, melons	7.7%	Russia(95.1%)/Turkey(2.0%) /Netherlands(0.6%)	371
28	Inorganic chemicals, precious metal compound, isotopes	5.4%	U.S,(50.7%)/France(22.0%) /Russia(11.9%)	238
71	Pearls, precious stones, metals coins, etc	3.8%	Japan(87.7%)/U.K.(8.2%) /Switzerland(1.7%)	174
07	Edible vegetables and certain roots and tubers	2.5%	Russia(92.8%%)/Georgia(1.7%) /Turkey(1.6%)	119
39	Plastics and articles thereof	2.2%	Russia(60.7%)/Ukraine(14.1%) /Lithuania(6.9%)	-27
79	Zinc and articles thereof	1.8%	Russia(32.2%)/India(32.0%) /Italy(16.3%)	89
85	Electrical, electronic equipment	1.1%	Russia(43.0%)/Hungary(31.1%) /Kazakhstan(18.9%)	-233

Source : Administration Agency of Masan Free Trade Zone(http://www.ftz.go.kr)

6. UN Comtrade data do not contain trade statistics reported by the Uzbek government. Therefore, we employ mirror statistics reported by its trading partners to calculate export figures in this table. We urge here the Uzbek government to prepare to report official trade statistics to international organizations as soon as possible.

On the other hand, Uzbekistan's export structure is more diverse than the other Central Asian countries, as it might be expected from its larger population and broader initial industrial base. For example, in case of Kazakhstan and Turkmenistan, a single sector of petroleum products accounts for 68.7 percent and 86.8 percent of total exports as of 2006, respectively. Similarly, aluminum sector is responsible for 65.3 percent of Tajikistan's total exports.

Furthermore, as depicted in <Table 1-8>, Uzbek exports continued to be diversified over the last decade and so on. This is quite a contrast to some of other CIS countries, notably Kazakhstan, Tajikistan and Turkmenistan where export concentration towards a few natural resource sectors dramatically increased.

Table 1-8 | Export Concentration of the CIS countries[7]

	1996	2001	2006
Advanced Countries	0.06	0.07	0.06
Developing Countries	0.10	0.1	0.14
Transition Economies	0.17	0.23	0.31
Azerbaijan	0.61	0.75	0.63
Kazakhstan	0.17	0.19	0.17
Kyrgyzstan	0.23	0.48	0.60
Russia	0.18	0.46	0.28
Tajikistan	0.26	0.32	0.38
Turkmenistan	0.48	0.54	0.77
Ukraine	0.45	0.53	0.61
Uzbekistan	0.54	0.33	0.29

Source : UNCTAD database

However, Uzbekistan still has quite a different export structure relative to the world average, as shown in [Figure 1-5]. Recently, export structures of most countries in the world become more similar with each other, mostly due to the expansion of global production network and of intra-industry trade.[8]

7. The degree of export concentration is calculated using the shares of each product(three-digit SITC, Revision 3 level) in a country's exports according the following formula:

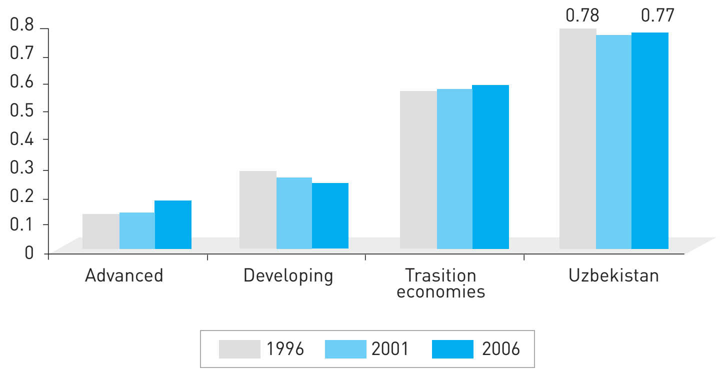
$$H_j = \frac{\sqrt{\sum_{i=1}^{n} (x/X)^2} - \sqrt{(1/n)}}{1 - \sqrt{(1/n)}}$$

where n is the number of products, x_i is the export value of product i and X the total value of exports for country j.

8. See Section 3-2 for definition and other details of intra-industry trade.

This is partly due to the gradual approach to transition into a market economy that the Uzbekistan government has maintained. Even though such an approach contributed to a somewhat less painful transition process, this led the economy to be relatively close off from the world economy. As an example, despite the base in production of raw cotton, Uzbekistan has not become a major textile exporter, as it is not incorporated into the buyer-driven networks that dominate such activities, presumably because of a lack of both trading contacts and international confidence in that country's legal and business environment(Myant and Drahokoupil, 2008).

Figure 1-5 | Extent of Export Dissimilarity by Country Group[9]



Source : UNCTAD database

3.2. Patterns of External Trade

As Lee (2009) illustrates, there are three different types of international trade. The first one is "Inter-industry Trade," which is an exchange of products of different industries. For example, one country specializes in the production and exports of automobiles where as the other country specializes in those of food. Inter-industry is mostly driven by differences in factor endowments or in technologies, leading to specification.

The second one is "Intra-industry Trade(IIT)," the exchange of products belonging to the same industry. Unlike inter-industry trade, trade occurs even between countries with similar factor endowments or technology level. For example, Germany exports BMW to the U.S., while

9. The extent of export dissimilarity for *a* country is calculated as:

$$DX_j = (sum|h_{ij} - h_i|)/2$$

where h_{ij} is the share of commodity i in the total exports of country j and h_i is the share of the commodity in world exports. This index that ranges from 0 to 1, reveals the extremal of the difference between the structure of trade of the country and the world average. The index value closer to 1 indicates a bigger difference from the world average.

the latter exports Ford into Germany. Economies would specialize to take advantage of increasing returns and thus lower costs, not following differences in resource endowments. In this case, it is more efficient if individual countries specialize in a limited variety of production and then trade them each other. This leads to a wider variety of goods available for consumption.

<Table 1-9> contains a cross-country comparison on the extent of intra-industry trade, calculated using the Grubel - Lloyd Index illustrated in Box 1-1. At the 3-digit level, only 6.2% of total trade for Uzbekistan can be identified as intra-industry trade. This is much lower than other countries in the table as well as the world average. As of 2006, the IIT average (unweighted) for the world total was about 0.138(i.e., 13.8 percent of total trade) at the 3-digit level.

Box 1-1 The Grubel and Lloyd Index

This index is a standard indicator of measuring the extent of intra-industry trade in terms of its share in total trade. The GL index is defined as

$$GL_{ci} = 1 - \frac{\sum_i | X_{ci} - M_{ci} |}{\sum_i (X_{ci} + M_{ci})}$$

where X_{ci} and M_{ci} refer to country c's exports and imports for an industry i respectively. The index is equal to zero in the absence of intra-industry trade, but to one in the absence of inter-industry trade.

Figure 1-9 | Extent of Intra-industry Trade by Country(2006)

	% of World trade	% of 5 digit sectors traded	IIT, 5 digit	IIT, 3 digit	Income Group (World Bank)
United States	13.2%	100.0%	0.317	0.503	High
China	9.7%	99.8%	0.182	0.305	Lower Middle
Korea	3.2%	99.6%	0.240	0.412	High
Russia	1.0%	99.0%	0.047	0.146	Upper Middle
Turkey	0.7%	99.1%	0.130	0.217	Upper Middle
Ukraine	0.3%	98.5%	0.115	0.274	Lower Middle
Kazakhstan	0.1%	95.9%	0.042	0.081	Upper Middle
Azerbaijan	0.0%	88.6%	0.011	0.041	Lower Middle
Uzbekistan	0.0%	82.3%	0.000	0.062	Low
World	-	83.3%	0.073	0.138	-

Source : Lee(2009)

Therefore, most of the Uzbek trade is inter-industry trade in nature. The importance of intra-industry trade for Uzbekistan remains stagnant, while countries' exports become more similar over time, due to the expansion of intra-industry trade. This also explains why the overall export structure of Uzbekistan remains quite different from other countries in the world, as depicted in [Figure 1-5]

The third type of international trade pattern that we would like to mention is "intra-firm trade," the exchange of products between parent firms at home and their subsidiaries abroad. This type of trade is in contrast with trade among unrelated parties, or say, arm's-length trade. Intra-firm trade is motivated by global operation of MNEs and upstream-downstream fragmentation across different locations. For example, a parent company at home sends parts and components to its subsidiary abroad, and the latter facilitates assembly process to produce final products. These final products then are sold locally or re-exported to the home country or 3rd countries in the world.

Unfortunately, data for intra-firm trade are largely unavailable, except a few developed countries, notably the U.S. In this paper, we examine Uzbek intra-firm exports into the U.S, using the U.S. data, in order to indirectly figure out the recent trend of intra-firm trade of Uzbekistan. Here intra-firm exports refer to within-firm transactions between parent firms in Uzbekistan and their foreign subsidiaries in the U.S.

As illustrated in <Table 1-10>, Uzbek intra-firm exports into the U.S. is virtually non-existent, while the world average reaches at 47.4%.

Table 1-10 | Extent of Uzbekistan Intra-firm Exports to the U.S.

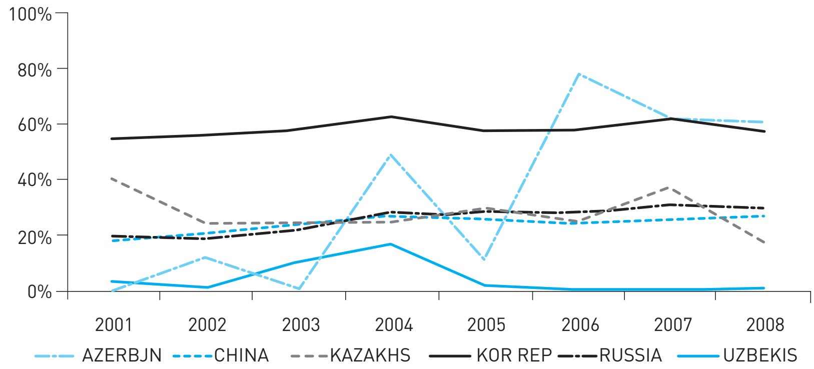
	2006	2007	2008
Agriculture and Livestock	1.7%	0.0%	0.0%
Oil, Gas, Minerals and Ores	0.0%	0.0%	0.0%
Manufacturing	0.0%	0.0%	1.0%
Others	0.0%	0.2%	0.0%
Total	0.0%	0.0%	1.0%

Source : U.S. Census Bureau

[Figure 1-6] compares the Uzbek's share of intra-firm exports relative to its total exports into the U.S. with those of some other countries. In 2008, the Korean share of intra-firm exports is about 57.5 percent. One interesting case is that of Azerbaijan's. The share of Azerbaijani intra-firm exports in total exports into the U.S. reached at 60.3% in 2008. Lee(2009) shows that this is mostly driven by petroleum and chemicals exports, while intra-firm exports for the other manufacturing exports are quite rare; only 0.9% of these exports are intra-firm exports.

In sum, the trade pattern of Uzbekistan can be characterized as inter-industry trade, with its major exports being agricultural and mineral products. This indicates that there exists a strong need for upgrading its exports mix towards some manufacturing sectors that global production network prevails.

Figure 1-6 | Cross-country Comparison on the Extent of Intra-firm Exports into the U.S.



Source : U.S. Census Bureau

3.3. Export Growth: Intensive Margin vs Extensive Margin

In Section 2, we discussed that patterns of export diversification differ depending on the specific stage of economic development. Low- and middle-income countries tend to diversify mostly along the extensive margin(i.e., growth of exports by adding new commodities) whereas high-income countries diversify along the intensive margin(i.e., growth of exports in goods that are already being exported) and ultimately re-concentrate their exports towards fewer products. According to Carrere et al.(2007), the turning point is estimated to be around 20,000~22,000 dollars per capita at purchasing power parity.

In reality, although many developing countries have tried to diversify their exports over the past couple of decades, not all of them have benefited from a more diversified export basket. During the 1960~90s, most Latin American economies achieved a substantial extent of export diversification, but their overall growth figures were somewhat disappointing.

To examine export growth pattern of Uzbekistan, we adopt an analytic approach proposed by Hummels and Klenow(2005). Hummels and Klenow(2005) decompose growth of trade flows into an extensive margin and an intensive margin, and examine on cross-country difference in trade patterns.

In this paper, extensive margin is defined as a weighted count of Uzbek export categories relative to the rest of world's export categories to a specific country or region. On the other hand, intensive margin refers to Uzbek exports relative to the rest of the world's exports in those categories in which Uzbek exports to a specific country or region. Detailed definition and methodology for these two margins are illustrated in Box 1-2.

Box 1-2 Intensive Margin vs Extensive Margin[10]

Let's first define the market share of country *k* relative to a set of other exporting countries *r* in a specific importing market. That is,

$$MS_t = \frac{M_{kt}}{M_{rt}} = \frac{\sum_{c \in N_{kt}} M_{kct}}{\sum_{c \in N_{rt}} M_{rct}}$$

where $M_{kt}(M_{rt})$ refers to the value of exports of country *k* (a set of the other exporting countries in the world) destined to a reference market. N_{kt} (N_{rt}) is the set of observable categories in which country *k* (a set of the other exporting countries in the world) has positive export value. We can re-write this formula as;

$$MS_t = \frac{\sum_{c \in N_{kt}} M_{rct}}{\sum_{c \in N_{rt}} \mathrm{M}_{rct}} \cdot \frac{\sum_{c \in N_{kt}} M_{kct}}{\sum_{c \in N_{rt}} M_{rct}} = EM_t \cdot IM_t$$

where EM_t and IM_t refers to extensive margin and Intensive margin, respectively.

Therefore, EM_t is defined as a weighted count of observable export categories in which country *k* (a set of the other exporting countries in the world) has positive export value, relative to the rest of world's export categories. If export quantity of all products is assumed to be equal, then EM_t is simplified into N_{kt} / N_{rt}. Hence, if EM_t is increasing, other things being equal, it implies that the set of export categories for country is larger.

On the other hand, IM_t is defined as to country *k*'s total exports relative to the other exporting countries' exports in those categories in which country *k* has positive export value. If IM_t rises, that implies that country *k*'s competitiveness increases in the categories in which country *k* actually exports.

<Table 1-11> reports extensive and intensive margins of Uzbekistan's exports by major export destination as of 2007. As for extensive margin, exports destined for Kyrgyzstan

10. The key reference for the contents of this box is Lee(2008b).

contains the widest set of export product categories, followed by the European Union, Kazakhstan and Russia. On the other hand, the extensive margins for non-CIS countries, other than the EU are fairly low, which indicates that export composition is largely concentrated in a limited number of products.

As aforementioned, intensive margin indicates Uzbekistan's total exports relative to the other exporting countries' exports in the categories in which Uzbekistan actually exports. In turn, this means Uzbekistan's market share relative to the other exporting countries' exports in these product categories. As shown in the Table, intensive margin for exports into Bangladesh is very high, reaching at 72.1 percent in 2007. This is due to its export concentration on agricultural products in the Bangladesh market. Other than Bangladesh, Kyrgyzstan and Kazakhstan, intensive margins are fairly low, indicating that the current export competitiveness of Uzbekistan in these markets is relatively weak.

Table 1-11 | Extensive vs Intensive Margin of Uzbek Exports by Region(2007)

Exports destination	Extensive Margin	Intensive Margin	Market Share
EU	30.4%	0.2%	0.06%
Russia	22.9%	3.4%	0.77%
China	5.1%	0.7%	0.04%
Turkey	10.8%	3.6%	0.39%
Kazakhstan	26.6%	6.3%	1.67%
Bangladesh	4.2%	72.1%	3.05%
Kyrgyzstan	48.9%	10.8%	5.28%
Japan	0.9%	3.0%	0.03%

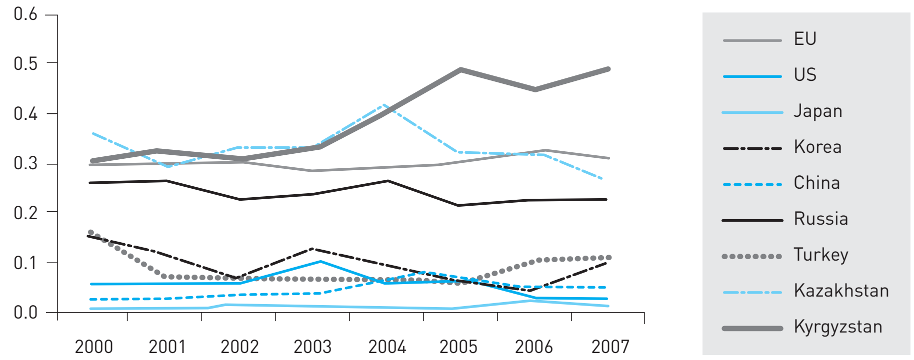
Source : Author's calculation based on the U.N. Comtrade database

Employing a similar approach adopted in this paper, Lee(2008b) estimates extensive and intensive margins for Korean exports into China. According to the estimation results, extensive margin reaches at 92.7% in 2007 whereas intensive margin is around 13.2%. This means that Korea exports most of the product categories in which other competing exporters actually export to China. In addition, Korea's competitiveness for the product categories that it currently exports is also strong and thus its relative market share in China is fairly high.

[Figure 1-7] and [Figure 1-8] depict the evolution of these margins for Uzbekistan by export destination for the periods of 2000-2007. Extensive margins for Uzbekistan's exports have been largely stagnant, with one notable exception of exports into Kyrgyzstan. Other than the latter case, extensive margins remain less than 40 percent for all of the cases analyzed. In particular, they are less than 10 percent for the cases of exports into the U.S., Japan, China and Korea. Finally, similar patterns are found in case of intensive margin.

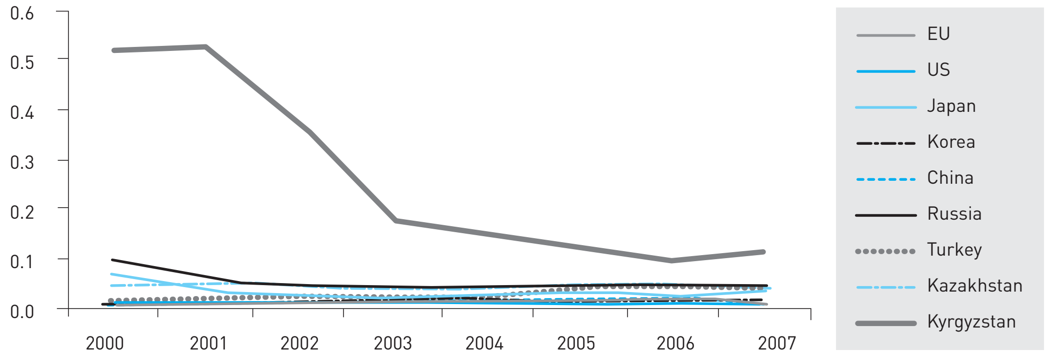
In sum, we can infer from these analyses that Uzbekistan is not successful in diversifying its export mix, as far as concerning its exports into major trading partners.

Figure 1-7 | **Extensive Margin by Export Destination(%)**



Source : Author's calculation based on the U.N. Comtrade database

Figure 1-8 | **Intensive Margin by Export Destination(%)**



Source : Author's calculation based on the U.N. Comtrade database

4. Priority Production Direction of the Navoi FIEZ

4.1. Selection Criteria

Taking the aforementioned discussions into account, we here evaluate and suggest possible production direction for the Navoi FIEZ, which could contribute to industrial upgrading of the overall Uzbek economy. As aforementioned, our analysis is based on the following criteria:

First, we employ the Commodity Complementarity Index approach to select industrial sectors that, even though currently underdeveloped, have a great export potential.

Second, given that one important advantage of the Navoi FIEZ over other FIEZs in the region is the air transport-logistic potential, we investigate a set of exporting products that could take advantage of such air transport-logistics, including electric/electronic parts and components, semi-processed machinery and equipment, textile, etc.

Third, we also examine specific demands of potential investors in terms of their production direction within the Navoi FIEZ, using surveys targeted to the Korean firms that visited Navoi.

4.2. Sectors of Great Export Potential

[Figure 1-9] contains a list of industrial sectors that the Uzbek government initially proposed in March 2009 as its priority production direction for the Navoi FIEZ. After that, however, with a readjustment process, the set of target industries are recently reduced into precision machinery & OECD parts for automobile industries, pharmaceutical industry and medical products, electronic and electrical engineering, food, and plastic products.

Figure 1-9 | Industrial Composition of Navoi FIEZ favored by the Uzbek Government(as of March 2009)

<Table 1-12> presents the current export status of industrial sectors that are listed in [Figure 1-9]. Other than transport equipment(HS 87), Food processing and packaging(HS 08), Inorganic chemicals et al.(HS 28) and plastic products(HS 39), the shares of these sectors in total exports of Uzbekistan is low. Furthermore, most of these sectors reveal trade deficits. For example, the net trade values of machinery and equipment(HS 84) and electric/electronic equipment(HS 85) in 2006 are △711 and △233 US million dollars, respectively.

According to Revealed Comparative Advantage(RCA hereafter) index that is often used for measuring export competitiveness for a specific sector, only transport equipment(HS 87), Food processing and packaging(HS 08) and Inorganic chemicals et al.(HS 28) reveal comparative advantage. The RCA indices for all the other sectors are close to zero, which indicates a substantially low export competitiveness in the world market.

However, as Hausman and Klinger(2006) suggest, economic growth may not be generally driven by such comparative advantage, but by countries' diversification of their investments into new activities. Efforts for diversifying export portfolio could be regarded as an investment in learning which products can be profitably sold in the external markets. Profitability in turn highly depends on market demand for exporting products. Therefore, it is sensible to look at how much the composition of exports for each sector matches with import demand for trading partners in the world market.

Table 1-12 | Export Competitiveness for Targeted Sectors(2006)

Products	HS code	Share in total Exports (%)	NetTrade (US$ thous.)	RCA Index
Transport equipment (Cars and their parts, etc)	87	10.17%	△119,521	1.2
Food Processing and Packaging (Edible fruit, nuts, etc)	08	7.67%	370,768	17.5
Inorganic Chemicals, Precious metal Compound, etc	28	5.37%	237,877	7.9
Construction materials (Stone, Plaster, Cement, etc)	68	0.04%	△ 14,407	0.1
Machinery & Equipment (Boilers, Machinery, etc)	84	0.45%	△711,037	0.0
Electrical/Electronic Equipment	85	1.10%	△232,866	0.1
Plastics and Articles thereof	39	2.22%	△ 27,777	0.7
Furniture, Lighting et al.	94	0.02%	△ 35,760	0.0
Textile, Leather and Apparel	60	0.14%	△ 15,935	0.8
	59	0.00%	△ 5,928	0.0
	57	0.00%	△ 10,516	0.0
	41	0.04%	1,874	0.2
	42	0.00%	△ 2,889	0.0
Perfumes and Cosmetics	33	0.00%	△ 24,771	0.0
Pharmaceutical and Medical Devices	30	0.02%	△157,548	0.0

Source : UN ITC database

In this context, we investigate here the correlation between Uzbek export specialization and other countries' import specialization, using the Commodity Complementarity Indices(hereafter CCI). CCI correlates economy *i's* export specialization pattern with economy *j's* import specialization pattern across the spectrum of all trade products(See Box 1-3, for more detail). We do this for each of the major trading partners, including Russia, Kazakhstan, Kyrgyzstan, the European Union, the U.S., Japan, Korea, China and Turkey.

[Figure 1-9] presents our computation results.[11] As we can see in the figure, the correlation of Uzbek exports with the import structure of Turkey(3.15) is the highest as of 2007, followed by China(1.47), Kazakhstan(1.41) and so on. Complementary relationship with Chinese imports had drastically increased in the early 2000s and then declined, while those with Korea, with Russia and with Turkey have been decreasing over the time span of the analysis.

Box 1-3. Commodity Complementarity Index(CCI)[12]

Commodity Complementarity Index(CCI hereafter) correlates economy i's export specialization pattern with economy j's import specialization pattern across the spectrum of all trade products. CCI is a trade-weighted measure for sectorof the degree to which the relative export share structure of economy i's exports (RXS_i^k) corresponds with the relative import share structure of economy j's imports (RMS_j^k) across all k commodities within the sector s.

$$CC_{ij}^{s} = \sum_{k \in s}\left[\theta^{k} \times RXS_i^{k} \times RIS_j^{k}\right]$$

where

$$\theta^{k} \equiv \frac{X_{ww}^{k}}{X_{ww}^{s}} \equiv \text{ share of product } k \text{ in sector } s \text{ for global exports}$$

$$RXS_i^{k} \equiv \frac{X_{iw}^{k} / X_{iw}^{s}}{X_{ww}^{k} / X_{ww}^{s}} \equiv$$ share of k in sectorfor i's exports, relative to share of k in sector s for global exports

$$RMS_i^{k} \equiv \frac{M_{jw}^{k} / M_{jw}^{s}}{M_{ww}^{k} / M_{ww}^{s}} \equiv$$ share of k in sectorfor j's imports, relative to share of k in sector s for global imports

Note that RXS_i^k is Balassa's revealed comparative advantage indices that CER(2004) use in their analysis. CCI equal to one represents a threshold, with a value greater(less) than one showing a greater(lesser) level of complementarity in the composition of what exporter i exports and what importer j imports than the average pair of countries.

11. In computation, HS-6 digit and HS-2 digit are regarded as individual commodity level k, and sector level s respectively.
12. The key reference for the contents of this box is Vollrath and Johnston(2001).

Figure 1-9 | CCIs for Selected Countries

Source : Author's calculation based on the U.N. Comtrade database.

<Table 1-13> reports CCI estimation results at sectoral level. We report only countries that reveal CCIs higher than 1, which can be regarded as potentially promising markets to increase Uzbek exports for each sector. If CCI is greater than 1, it means that a greater complementarity between Uzbek exports and an importing country's imports than the average pair of countries.

In case of electric/electronic equipment(HS 85), the EU and Russian markets show a relatively high degree of complementarity with Uzbek exports than other major importers. Similarly, Uzbek export specialization pattern for machinery and equipment(HS84) matches fairly well with import patterns of the EU and Russia. Among other sectors, furniture(HS 94), plastic products(HS 39), pharmaceuticals(HS 30) and some mineral products(HS 74 & 75) are showing a great complementarity with a number of major trading partners.

One thing that we would like to mention here is that the CCI analysis does not explicitly take into account trade costs. This is a clear methodological limitation of the CCI analysis. For example, even though the U.S. shows a great complementarity with the Uzbek exports for a number of sectors, such as edible vegetables(HS 07), transport equipment(HS 87), etc, it is relatively hard to imagine for Uzbekistan to export these products into the U.S. market in the short-term. This is quite an important factor to be considered when the government set ups and implements export diversification strategy in terms of potential export destination.

Table 1-13 | CCIs for Major Exporting Markets of Uzbekistan by Sector(2006)

HS code	Industry	CCI >1 (2007)
85	Electrical, electronic equipment	EU(3.57), Russia(3.49), Kazakhstan(2.20), Kyrgyzstan(1.23), Japan(1.19), US(1.03)
84	Machinery & Equipment (Boilers, Machinery, etc)	Russia(19.97), EU(13.78), Kazakhstan(2.07), Kyrgyzstan(1.68), Turkey(1.26), Bangladesh(1.17), Korea(1.02)
94	Furniture, lighting, signs, prefabricated buildings	Bangladesh(4.66), Kazakhstan(2.32), Kyrgyzstan(1.64)
39	Plastics and articles thereof	Bangladesh(1.61), Turkey(1.24), China(1.16)
08	Edible fruit, nuts, peel of citrus fruit, melons	China(1.11), US(1.10)
07	Edible vegetables and certain roots and tubers	US(1.11)
30	Pharmaceutical products	Russia(1.82), Korea(1.52), Japan(1.26), EU(1.10)
87	Vehicles other than railway, tramway	US(1.74), Kazakhstan(1.02)
28	Inorganic chemicals, precious metal compound, isotopes	US(2.33), Kazakhstan(2.30), Japan(1.15)
74	Copper and articles thereof	Turkey(1.70), Bangladesh(1.42), Korea(1.16), US(1.14), Kazakhstan(1.03)
79	Zinc and articles thereof	Bangladesh(1.61), Turkey(1.19), Kazakhstan(1.12), Korea(1.08), US(1.04)
68	Stone, Plaster, Cement, Asbestos, mica, etc	US(1.25), Kazakhstan(1.18), Japan(1.04)

Source : Author's calculation based on the U.N. Comtrade database.

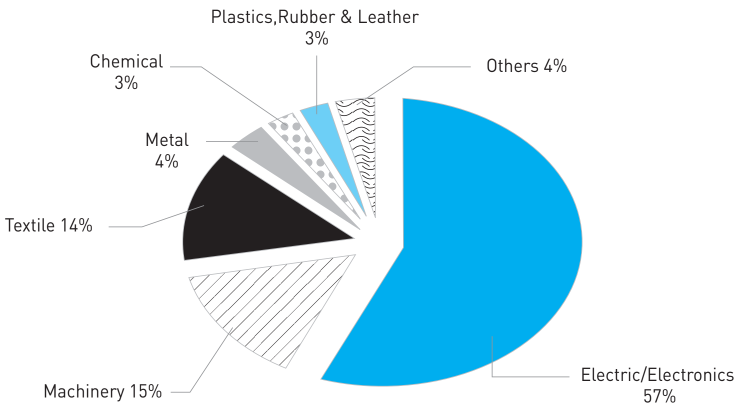
4.3. Sectors of High Air Transport-logistic Potentials

One infrastructural advantage of the Navoi FIEZ is that the zone is located in the area of the Navoi international airport. The airport is currently aiming to be transformed into an international logistics hub, which will then become the center for processing regional cargo and distribution of goods and services. Air communication has been established from Navoi to Milan, Brussels, Bangkok, Delhi and Mumbai. Routes to Frankfurt, Dubai, Istanbul and Tel-Aviv will also open soon. It is expected that the Navoi airport will reduce the distance of the international air traffic for more than three times through the Navoi hub from South East Asia to South and North America.

In this process, the Korean Air, the world's largest air cargo carrier, is taking an active part in the development of the intercontinental logistics center in the Navoi region. The Korean Air has signed a formal deal with state-run Uzbekistan Airways to expand co-operation in international air cargo services.

Taken this infrastructural advantage into account, it is natural to consider sectors of high air transport-logistic potential, in determining priority production direction of the Navoi FIEZ. [Figure 1-11] reports the sectoral composition of the Korean airfreight as of 2006. We could see that electric/electronic products take the lion's share in terms of tonnage, accounting for 57 percent of the total air freight, followed by machinery and equipment (15 percent), textile (14 percent), metal products (4 percent) and so on.

Figure 1-11 | Industrial Composition of Navoi FIEZ favored by the Uzbek Government(as of March 2009)



<Table 1-14> contains the detailed product composition in case of the Korean electric/electronic Airfreight. Cellular phones account for 19.9 percent of total electric/electronic Airfreights in terms of tonnage, and then semiconductor(10.2 percent), LCD panel(10.2 percent) and LCD monitor(8.5 percent) follow. While most of the airfreights are light in weight and small in volume, other than cellular phones and audio devices, they are mostly capital goods and parts/components.

In case of machinery and equipment, major air freights are automobile parts, moulds for rubber/plastics, hand tools, parts and accessories of cameras, etc. As we can see, they are also mostly parts/components and semi-processed products. Finally, major air freights of textile sectors are pile or knitted fabrics, woven polyester fabrics, T-shirts, which are mainly semi-processed goods and consumer goods.

Table 1-14 | Product-level Composition of Korean Electric/Electronic Airfreight(2007)

Product	HS code	Type	Tonnage	%
Cellular Phones	852520	Capital goods Consumer goods	56,274	19.9%
LCD Monitor	847310, 852290, 854390, 901790	Parts and Components	23,978	8.5%
LCD Panel	853180	Capital goods	28,709	10.2%
Semiconductor	847330, 854389 854121, 854129, 854210, 854229, 854290	Capital goods Parts and Components	28,776	10.2%
Parts (Cellular Phones)	852990	Parts and Components	19,547	6.9%
HDD Memory	847170	Capital goods	18,668	6.6%
Computer & Parts	847130, 847141, 847149, 847150 847330, 852290	Capital goods Parts and Components	8,413	3.0%
Parts(Color TV)	852990	Parts and Components	14,601	5.2%
Audio devices	852739 852729 851999, 852712, 852713, 852719	Capital goods Parts and Components Consumer goods	6,193	2.2%
Printed Circuits	8563400	Parts and Components	8,695	3.1%
Others	-	-	68,945	24.4%

Source : Korean KOTIS database

4.4. Potential investors' production priority

Some businesses from Korea, China, India, among many others, are highly interested in investing in the prospective project on 'Establishing the First Free Industrial Economic Zone of Uzbekistan.' In particular, more than 100 South Korean businessmen visited the Navoi FIEZ to familiarize with the project and participate in the business-forum at the beginning of June last year. Another group of businessmen led by the Chairman of Korea Federation of Small and Medium Business visited Uzbekistan in July last year to see the investment opportunities provided in the Navoi FIEZ. As a result, a number of agreements on cooperation have already been signed with the South Korean companies. A number of projects have been also developed with the Chinese partners. For some examples of the projects realized by non-Korean companies are as follows: automobile OEM parts production project with Indian “Minda Capital,” digital set-top-box receivers production project with Singapore “Servetechno,” polyethylene pipes and polypropylene pipes projects with Omani “Oman Oil,” fiber-optical wires production project with “Oman Fiber Optical” or fruit and vegetable production conservation and packing project with UAE “Kefayat General Trading.”

<Table 1-15> presents a survey results pursued for 92 Korean businessmen who visited Navoi in June last year, in order to examine specific demands of potential investors in terms of their production direction within the Navoi FIEZ. Among manufacturing sectors, 32 businessmen show their intention to produce automobile parts and electric/electronic products in the Navoi FIEZ.

Table 1-15 | Survey Results for Korean Investors(as of June last year)

Sector	Number of Firms	Composition(%)
Distribution, Wholesale and Retail	20	21.7%
Transport Equipment including automobiles and their parts	16	17.4%
Electric, electronic equipment	16	17.4%
Construction Engineering and Materials	16	17.4%
Other Machinery and Equipment	9	9.8%
Metal and Other Minerals Processing	6	6.5%
Paper, Textile and Apparel	5	5.4%
Chemicals	2	2.2%
Medical Devices	2	2.2%
Furniture	1	1.1%
Total	92	100.0%

5. Summaries and Conclusion

Recognizing the urgent need for industrial diversification, the Uzbek government recently launched a Free Industrial Economic Zone project at the Navoi region. This project is a quite sensible policy move for the long-term sustainable growth of Uzbekistan.

The introduction of the first FIEZ in Uzbekistan to achieve export diversification would bring externalities into the domestic economy such as technological spillovers, which is an important determinant for long-run sustainable growth. In addition, this project could provide a stimulus for the creation of new industries and/or expansion of existing sectors, through industrial backward and forward linkages.

Vertical diversification via the Navoi FIEZ, in particular, could play an important role for the long-term viability for the Uzbek economy. Uzbekistan has been relatively closed off from the world market in terms of participating in the global production networks that are gaining more and more importance in the world market. As a result, most of the current trade of Uzbekistan is inter-industry trade in nature. Major exports are also geographically concentrated around the CIS countries.

This chapter examined possible priority production direction in terms of industrial composition within the Navoi FIEZ. Our analysis is based on three distinct criteria and the main results are summarized in <Table 1-16>. First of all, according to the results from the Commodity Complementarity Index analysis, Electric/electronic equipment, Machinery and Equipment, Furniture and metal processing are industrial sectors that, even though currently

Table 1-16 | Priority Sectors for the Navoi FIEZ

Criterion	Sectors
Potentials for Complementarity	Electric/electronic equipment, Machinery and Equipment, Furniture, metal processing
Air transport potentials	Electric/electronic equipment, Machinery and Equipment, Textile, some metal products
Interest shown by potential investors	Automobiles and their parts, Electric/electronic equipment, Machinery and Equipment, Construction engineering and materials, metal processing

underdeveloped, have a great export potential .

Second, our analysis suggests that Electric/electronic equipment, Machinery and Equipment, Textile and some metal products are a set of exporting products that could take advantage of such air transport-logistics, which is an important infrastructural advantage of the Navoi FIEZ.

Finally, basing on a survey targeted for potential investors to the Navoi FIEZ, we find that they are interested in producing Automobiles and their parts, Electric/electronic equipment, Machinery and Equipment, Construction engineering and materials and metal processing in the Navoi Zone.

Taking these results altogether into account, we can conclude that automobile parts, electric/electronic equipment and other machineries are good candidates for priority production direction of the Navoi FIEZ. In fact, this is quite consistent with the current status of the Navoi project, presented in <Table 1-17>. Currently, more than a half of foreign investors who decided to invest in the Navoi soon or later revealed their intention to produce automobile parts and electric/electronic equipment. Hence it seems sensible to jump start the Navoi FIEZ in this production direction.

Table 1-17 | Industrial Composition of the Navoi FIEZ(as of January, 2010)

Sector	Number of Firms	Composition(%)
Transport Equipment including automobiles and their parts	5	33.3%
Electric, electronic equipment	4	26.7%
Other Machinery and Equipment	2	13.3%
Paper, Textile and Apparel	1	6.7%
Chemicals	1	6.7%
Others	2	13.3%
Total	15	100.0%

As a final remark, we would like to remind one important aspect. While FIEZs could serve as an enclave to achieve specific policy objectives, bypassing weakness in administrative and infrastructural capacity, they are in fact a sub-optimal policy, relative to country-wide trade liberalization. FIEZs could distort resource allocations in an economy while its direct benefits tend to be geographically concentrated around the FIEZs.

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Chapter 02

Investment Promotion Strategy and Systemization

1_ Regional Investment Decision Factors
2_ Investment Environment of Uzbekistan
3_ Korea's FDI and National Investment Promotion Agency
4_ Investment Promotion Strategy and Systemization in Navoi FIEZ
5_ Suggestions

Chapter 02

Investment Promotion Strategy and Systemization

Doo Gyu Park (Korea Trade-Investment Promotion Agency)

1. Regional Investment Decision Factors

Recently super economic regions, global network model etc. are emerging in regional investment decision theories. This part will briefly review these new concepts and trends.

1.1. New Trend in Regional Development: Super Economic Regions

Kenichi Ohmae insists that region states are appropriate spatial units in the borderless global economy in The Borderless World(1996). Population of region states is from 5 million to 20 million. He emphasizes the importance of infrastructures such as telecommunication, international airport, international port, etc. Also he suggests success factors of region states such as specialization in region, differentiated competitiveness, flexibility in environmental change, localized marketing, etc.

Scott(2001) insists that global city - regions of global competitiveness and political autonomy - are emerging as new main agents of economic activity in the globalized economy to cope with globalization, glocalization trends and reinforcement of regional competitiveness.

Richard Florida insists the concept of global mega-region which has characteristics such as free movement of labor and capital, mass population and specialized labor force, highly innovative activities, etc. 40 global mega-regions with production of more than 100 billion US dollars compose 18% of the world population, 66% of the world economic power and 85% of the world's technology science innovation.

1.2. Composition of Regional Economic Capabilities by Super Economic Regions (in Korea)

The policy of the super economic regions development is the key economic policy area of the new Korean government. This policy aims to promote competitiveness of the Korean industries in the global economy and to accelerate the transition by the Korean industries to create a more knowledge-based economy. Therefore, it is important to design policies to reduce inefficiencies and redundancies. The research(KIET, 2008) analyzed agglomeration patterns of industry and innovation in super economic regions and investigated the spatial coalition of companies based on their activities. The research investigated the regional economic capabilities by super economic regions of index for the regional economy level based on the regional statistics such as income level, innovation capacities, level of human resources, the level of industry development, SOC and local finance situation. The results show that the stronger the agglomeration of industry, the higher the rank of the regional economic level. These results suggest following policy implications: First, the expansion of human resource development and the infrastructure of the industry development are needed to enhance potential regional growth. Second, different regional development strategies should be applied because of the differences in the economic situation of each region. Last, the capacity for innovation should be strengthened through networks and partnerships.

Table 2-1 | Composition of Regional Economic Capabilities by Super Economic Regions(in Korea)

		Sign(+, -)	Weight
Income Level	local production	+	1/2
	local consumption	+	1/2
Innovation Capacities	knowledge resources	+	1/3
	knowledge investment	+	1/3
	knowledge performance	+	1/3
Level of Human Resources	population change	+	1/3
	population structure	+, -	1/3
	education	+	1/3
Industry Development	industrial development	+	1/2
	industry structure	+	1/2
OC/ Local Finance	SOC	+	1/2
	local finance	+	1/2

Source : KIET(2008), Strategies for Promoting Regional Industry in the Super Economic Region.

1.3. Global Network Model

Global Network Model(hereafter GNM) is a new industrial organization type which raises cost competitiveness and flexibility through split and relocation of value chain. GNM coordinates company relationship through outsourcing of value chain except core competence and contract. The scope of value chain outsourcing is broadening gradually to R&D and after service and is spreading all over the world. GNM splits its value chain such as R&D, manufacturing, marketing, etc. and operates its business activities in the global optimum locations.

Table 2-2 | Global Network Model

	Vertical integration	Vertical interrelation	Regional cluster	Global network
External delegation	(internal company)	parts. material-based	parts. Material, development, sales	R&D
Regional scope of external delegation	(entry of foreign country)	specific regional agglomeration (limited foreign country)	specific regional agglomeration	global dispersion (decentralization)
Relation with company	single company	equity, long-term cooperation	independent and social cooperation	independent contract

Source : SERI(Samsung Economic Research Institute), 2008

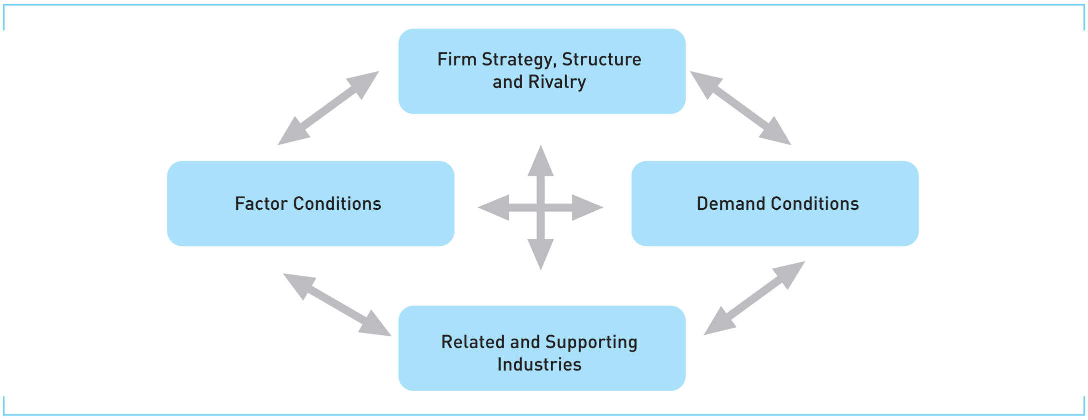
1.4. Decision Factors of Regional Investment

According to the optimal capital stock theory, profit maximization of a company is a composite function of revenue, cost and risk. It means maximization of net present value. In other words, it is a question of how to minimize cost and how to control risk or how to minimize risk.

According to UNCTAD(1998), FDI motives are composed of economic factors, policy factors and business convenience. Economic factors are market-seeking, resource/asset-seeking, efficiency-seeking, strategic assets and capacity-seeking. Policy factors are political stability, discrimination of internal and external company, privatization, etc. Business convenience is efforts of inbound FDI, investment incentives and convenient residences, etc.

M. Porter(1990) of Harvard University insisted that national competitiveness is composed of four conditions such as factor, demand, firm strategy, structure, and rivalry related and supporting industries. Factor conditions are labor cost, labor skills, labor supply, availability of raw materials etc. Demand conditions are market size, competition pressure, relationship with customers, test market to global market, etc. Strategy, structure and rivalry conditions are market importance, competitive advantage of product, protection of intellectual property, transparency in business environment, etc. Conditions of supporting industries are industry clustering, up and downstream industry, logistics, ICT, etc.

Figure 2-1 | M. Porter(1990), Determinants of National Competitive Advantage(Diamond Model)



Decision factors of regional investment are summarized such as internal factors, external factors, and regional investment environment in <Table 2-3>.

Table 2-3 | Decision Factors of Regional Investment: Summary

Internal Factors	IRR(internal rate of return) Financial status(debt ratio, internal reserve) Management strategy (conservative management, entrepreneurship) Governance (owner, professional manager)		
External Factors	National Factors	Revenue	cyclic demand(production quantity), exchange rate
		Expense	interest rate, capital goods, relative price, exchange rate, tax
	Regional Factors	Revenue	GRDP, agglomeration effect, incentive
		Expense	Human resources. land, financing, Infrastructure, administrative expense
Regional Investment Environment	Production (human resource, land, finance) Industry agglomeration (market demand, related business) Infrastructure (physical, intellectual, residential) Policy (deregulation, investment incentive)		

Source : KIET(2009)

1.5. Importance of Regional Investment Environment

KCCI(Korea Chamber of Commerce and Industry)(2007) surveyed 3,651 Korean companies to inquire the importance of regional investment environment. For four categories, the results on the importance of production, industry agglomeration, infrastructure, policy were 0.310, 0.271, 0.237, and 0.182 respectively. In ten composites, the ranking is in the order of physical infrastructure(such as SOC, logistics, utility), human resources(such as production crew, professional, labor relations), related businesses(up and down streams, business supporting) , market demand, deregulation, etc.

Table 2-4 | Importance of Regional Investment Environment(Korean case)

4 Categories	Importance	10 Composites	Importance	Ranking
Production	0.310	human resources	0.173	2
		land	0.062	8
		finance	0.075	7
Industry Agglomeration	0.271	related business	0.144	3
		market demand	0.127	4
Infrastructure	0.237	physical	0.193	1
		intellectual	0.015	10
		residential	0.029	9
Policy	0.182	deregulation	0.097	5
		investment incentive	0.085	6

Source : KCCI, 2007
Note : 1. Effective Sample Size : Korean Companies 3,651
2. Multiple Responses(4 in 4 Categories, 2 in 10 Composites)

2. Investment Environment of Uzbekistan

2.1. Inbound FDI(Foreign Direct Investment) in Central Asia

Because of the global financial crisis, inbound FDI of Central Asia decreased drastically, especially inbound FDI of Kazakhstan decreased 23% in 2008, compared to 2007. But for Uzbekistan, inbound FDI increased 279% in 2007, compared to 2006, and in 2008, 35% increased compared to 2007. To secure crude oil and natural gas, Russia, China, Japan invested actively.

Lukoil and Gazprom of Russia invested in energy development. CNPC (China National Petroleum Corporation) and CNODC (China National Oil & Gas Exploration and Development Corporation) invested 244 million and 25 million US dollars respectively. In case of Japan, JICA(Japan International Corporation Agency), JBIC(Japan Bank for International Corporation) and Keidanren invested actively.

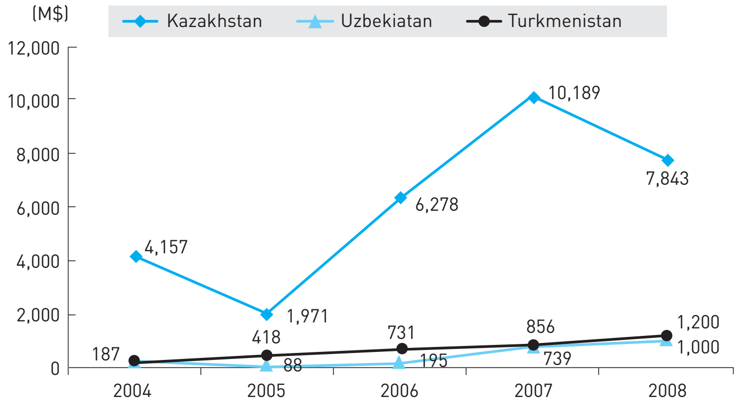
Table 2-5 | Inbound FDI in Central Asia

(Unit: Million $)

	2004	2005	2006	2007	2008
Kazakhstan	4,157	1,971	6,278	0,189	7,843
Uzbekiatan	187	88	195	739	1,000
Turkmenistan	354	418	731	856	1,200
Kyrgyzstan	132	43	182	208	193
Tajikistan	272	54	339	360	-

Source : IMF, World Economic and Financial Surveys: World Economic Outlook-Crisis and Recovery, April 2009

Figure 2-2 | **FDI in Energy Exporting Countries**

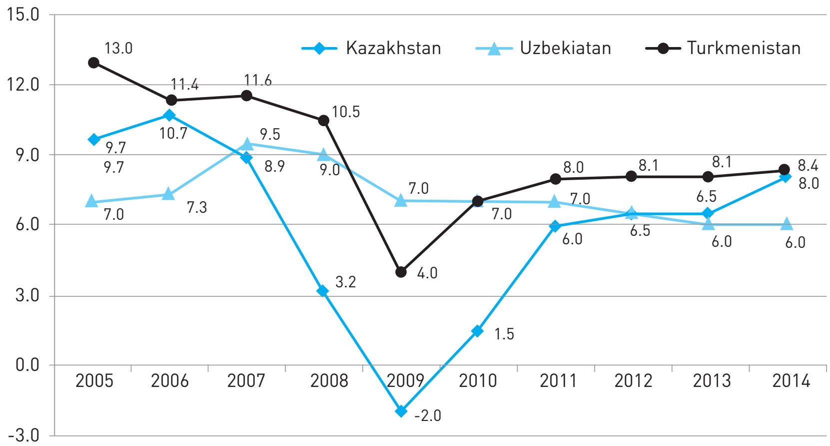


Source : IMF, World Economic and financial Surveys: World Economic Outlook-Crisis and Recovery, April 2009

2.2.GDP Growth in Central Asia

In spite of global financial crisis, GDP growth of Uzbekistan in 2009 was 8.7% through the government' s strong financial and price stabilization policy. IMF forecasts high GDP growth of 6-7% from 2010 to 2014.

Figure 2-3 | **GDP Growth in Central Asia**



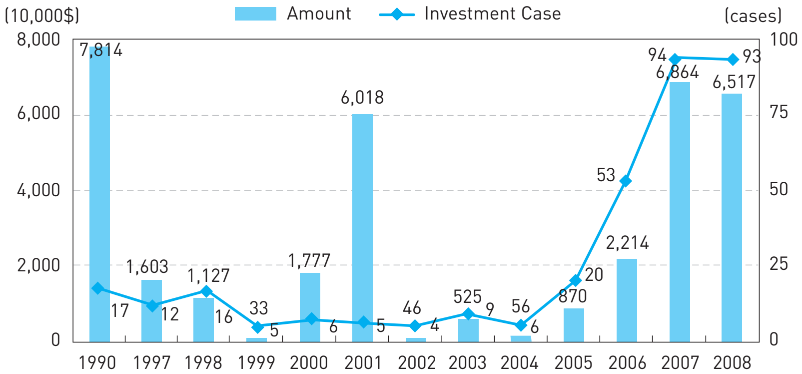
Source : IMF, World Economic and Financial Surveys: World Economic Outlook-Crisis and Recovery, April 2009
IMF, Regional Economic Outlook: Middle East and Central Asia, October 2009

2.3. Uzbekistan FDI of Korea

Uzbekistan FDI of the Korean companies increased rapidly after Korean president's official visit in 2005. Accumulated amount of investment by 2008 is 46,671 k US dollars and the number of accumulative investment cases is 140.

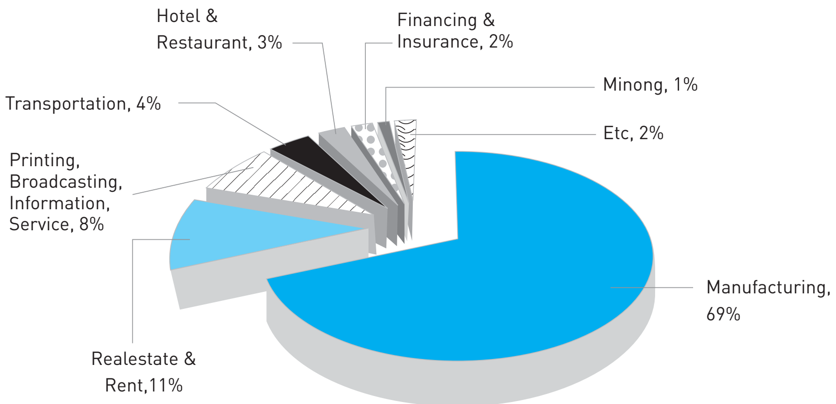
69% of Uzbekistan FDI in 2008 was manufacturing, the amount is 31,932 k US dollars. With the exchange visits and summits by the presidents, the two countries have reinforced their economic cooperation and Korea's investment to Uzbekistan is expected to increase rapidly.

Figure 2-4 | Uzbekistan FDI of Korea



Source : Korea EXIM Bank, 2009
Note : 26,696k US $ by Sep. 2009

Figure 2-5 | Uzbekistan FDI of Korea by Industry



Note : FDI accumulation by, 2008
Source : Korea EXIM Bank, 2009

2.4. Uzbekistan's FDI Environment

FDI environment of Uzbekistan needs improvement. Uzbekistan's ranking on the degree of economy freedom in 2009 was 148th. The scores on business environment, trading, government intervention, monetary policy were low. Especially the score on foreign investment, financial system, property, corruption were very low.

Uzbekistan's ranking in Doing Business 2010 by the World Bank went down compared to that of 2009. Especially the ranking of starting a business, paying tax, ease of doing business, protecting investors went down. The ranking of trading across borders is still 174.

Table 2-6 | Degree of Economy Freedom in Central Asia(2009)

	Kazakhstan	Uzbekistan	Kyrgyzstan	Tajikistan	Azerbaijan	Turkmenistan
Rank	83	148	74	122	99.0	169
Composite Score	60.1	50.5	61.8	54.6	58.0	44.2
Business Environment	57.8	68.4	75.3	45.1	74.6	30.0
Trading	86.2	65.4	87.6	82.6	78.4	79.2
Tax	82.8	88.3	93.4	89.3	79.7	90.9
Government Intervention	87.5	68.1	74.9	85.9	77.5	93.6
Monetary Policy	70.0	62.6	71.5	63.2	66.3	68.0
Foreign Investment	30.0	30.0	50.0	30.0	30.0	10.0
Financial System	60.0	20.0	50.0	40.0	40.0	10.0
Property	25.0	20.0	25.0	30.0	25.0	10.0
Corruption	21.0	17.0	21.0	21.0	21.0	20.0
Labor Market	80.5	64.9	69.5	58.7	87.0	30.0

Source : Heritage Foundation
Note : Score 0(Max)-100(Min)

Table 2-7 | Doing Business 2010 Ranking in Uzbekistan

Doing Business	2010	2009	Changes in Ranking
Ease of Doing Business	150	145	-5
Starting a Business	92	71	-21
Dealing with Licenses	142	148	+6
Employing Workers	95	91	-4
Registering Property	133	130	-3
Getting Credit	135	131	-4
Protecting Investors	119	114	-5
Paying Taxes	178	164	-14
Trading Across Borders	174	174	0
Enforcing Contracts	44	45	+1
Closing a Business	125	124	-1

Source : World Bank , Doing Business 2010

Table 2-8 | Comparison of Business Environment in Trading Across Borders of CA

	Uzbekistan			Kazakhstan	Tajikistan	Kyrgyzstan	Russia	Average of Eastern Europe & CA	Average of OECD
Year	2008	2009	2010	2010	2010	2010	2010	2010	2010
Rank of Doing Business	138	145	150	63	152	41	120		
Rank of Trading Across Borders	165	174	174	182	179	154	162		
Export Costs	2,550	3,100	3,100	3,005	3,150	3,000	1,850	1,582	1,090
Import Costs	4,050	4,600	4,600	3,055	4,550	3,250	1,850	1,774	1,146
Exporting Documents (Number)	7	7	7	11	10	7	8	6.5	4.3
Importing Documents (Number)	11	11	11	13	10	7	13	7.8	4.9
Exporting Time(Days)	80	80	71	89	82	63	36	26.8	10.5
Importing Time(Days)	104	104	92	76	83	72	36	28.4	11.0

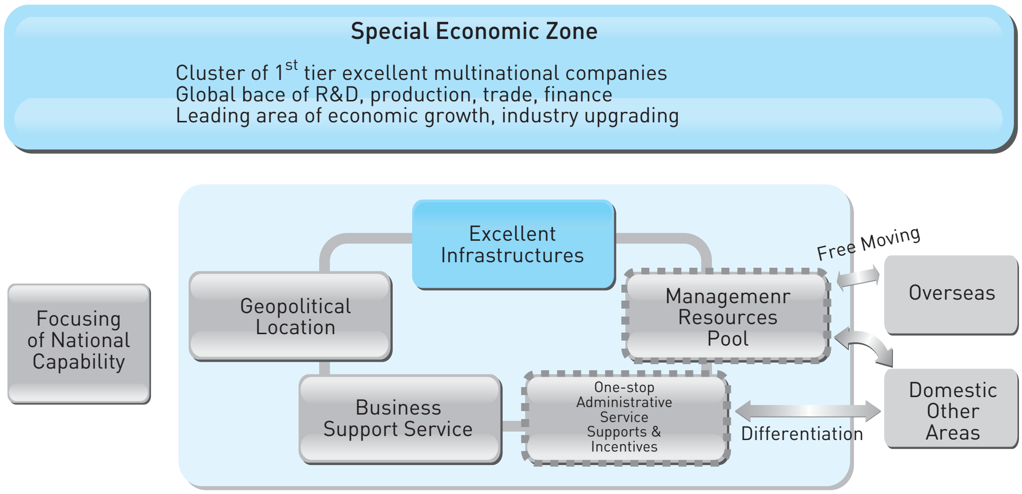
Source : World Bank , Doing Business 2010

3. Investment Promotion Strategy and Systemization in Navoi FIEZ

3.1. Key Factors of Success in Navoi FIEZ

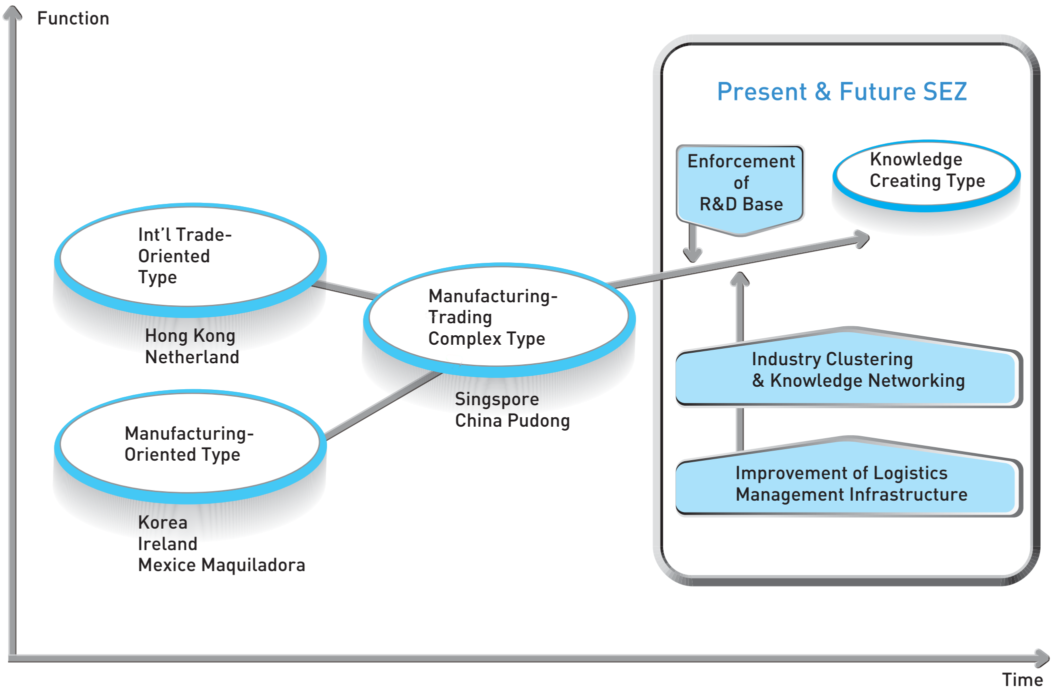
To succeed in setting-up a good Special Economic Zone(SEZ), we have to fulfill and consider geopolitical location, excellent infrastructure, management resources pool, business support service, one-stop service supports & incentives and national capability, free moving to overseas, etc. SEZ is developing rapidly, recently focusing on knowledge creating type through enforcement of an R&D base, industry clustering & knowledge networking, improvement of logistics, management infrastructure, etc.

Figure 2-6 | Concept of a Special Economic Zone(SEZ)



Source : Samsung Economic Research Institute(SEZ), 2002, 09

Figure 2-7 | Development of a Special Economic Zone(SEZ)



Source : Samsung Economic Research Institute(SEZ), 2002, 09

Key Factors of Success in Navoi FIEZ

The first key factor of success is access to rich raw material base, its deep processing and production of higher value added goods. Beneficial geographical location close to the largest markets and transport-logistic potential are also key factors. The fourth key factor is well-educated human resources and huge intellectual potential. Finally, vast opportunities to create an environmentally-friendly, modern and diversified industrial base is the fifth factor crucial to success(Source: H. E. Elyor Ganiev, Free Industrial Economic Zone in NAVOI, New Investment Opportunities for Korean Partners in Uzbekistan, March. 2009).

3.2. Incentives and Preferences for Foreign Investors

The FIEZ residents are exempted from Land Tax, Property Tax, Profit(income) Tax, Unified Tax(SMES), Obligatory Payments to the Republican Road Fund, and the Republican Fund of Elementary and Secondary Education

Period of Privileges and Incetives

The privileges and incentives can be enjoyed for 7 years if the amount of direct investments is 3-10 million Euros. That period of time could be extended to 10 years with direct investment of 10-30 million Euros and 50% reduction of profit tax for the following 5 years. With more than 30 million Euros of direct investments and 50% reduction of profit tax for the following 10 years, there would be a 15 year period of privileges and incentives.

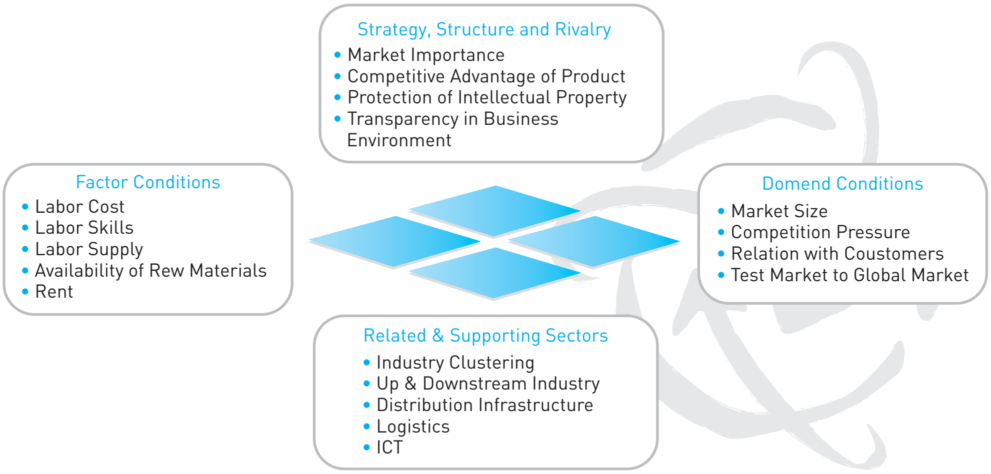
Registered enterprises of for the whole period of FIEZ functioning to produce export goods are exempted from customs duties for imported Equipment, Raw Materials, and Production Components(Source: H. E. Elyor Ganiev, Free Industrial Economic Zone in NAVOI : New Investment Opportunities for Korean Partners in Uzbekistan, March. 2009).

3.3. Perception of the Korean Companies on Investment Environment of Navoi FIEZ

3.3.1. Survey Profile

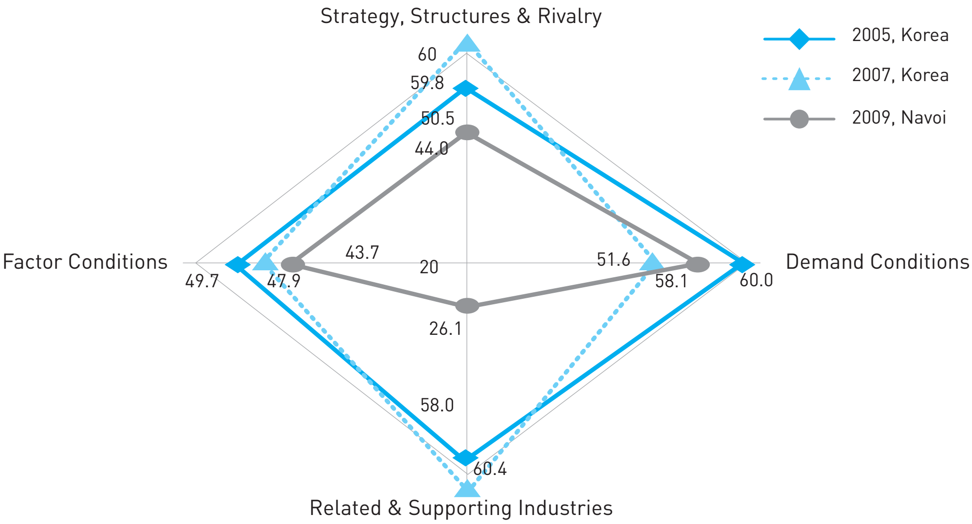
To find out the perception of the investment environment of Navoi FIEZ by the Korean companies - companies that visited Navoi FIEZ in 2009 led by KFSB(Korea Federation of Small and Medium Business) - KDI surveyed using M. Porter' s Diamond Model and questionnaire from October to November in 2009. Among the companies surveyed, 59 responded. Also the report compared the survey result with other surveys done by the Ministry of Knowledge Economy(MKE) in 2005 and in 2007 on six hundred Korea inbound invested companies.

Figure 2-8 | M. Porter's Diamond Model



The diamond of Navoi FIEZ(factor 43.7, demand 58.1, strategy 44.0, related industries 26.1) was compared to that of Korea in 2007 and 2005. In particular, the score of related & supporting industries was only 26.1 compared to 60.4 of Korea in 2007.

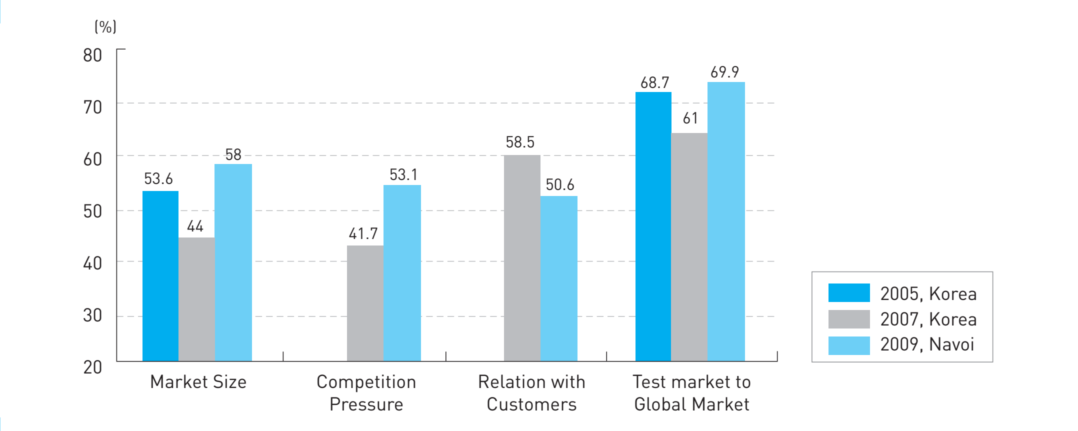
Figure 2-9| Survey Summaries



Source : 1. MKE etc. Management Condition Survey of Foreign Invested Company in 2008, February. 2009
2. KDI Questionnaire Survey for Navoi FIEZ Activation, October. 2009
Note : Based on a Scale of 7

Concerning demand conditions, the score of relationship with customers was low compared to that of Korea.

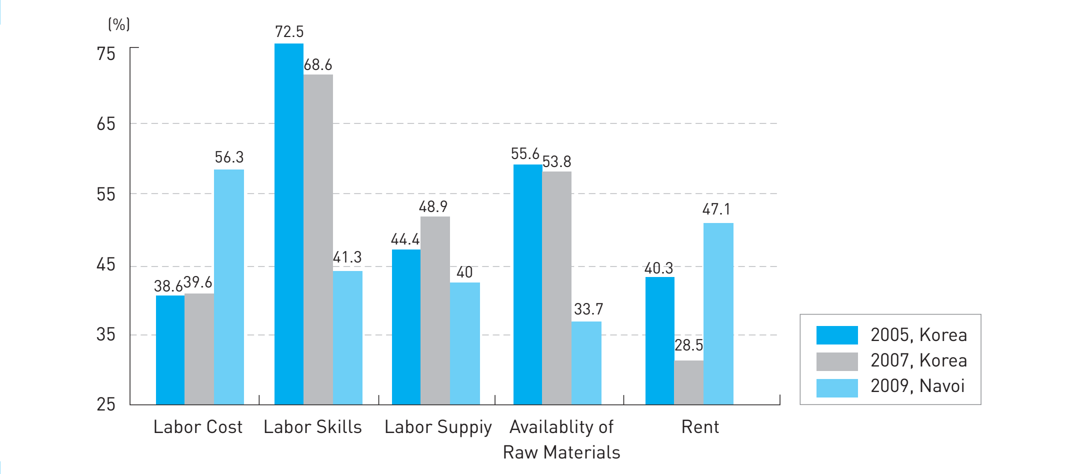
Figure 2-10 | Demand Conditions(average 58.1%)



Source : 1. MKE etc, Management Condition Survey of Foreign Invested Company in 2008, February. 2009
2. KDI Questionnaire Survey for Navoi FIEZ Activation, October. 2009

Concerning factor conditions, the score of labor skills, labor supply, availability of raw materials were low compared to that of Korea.

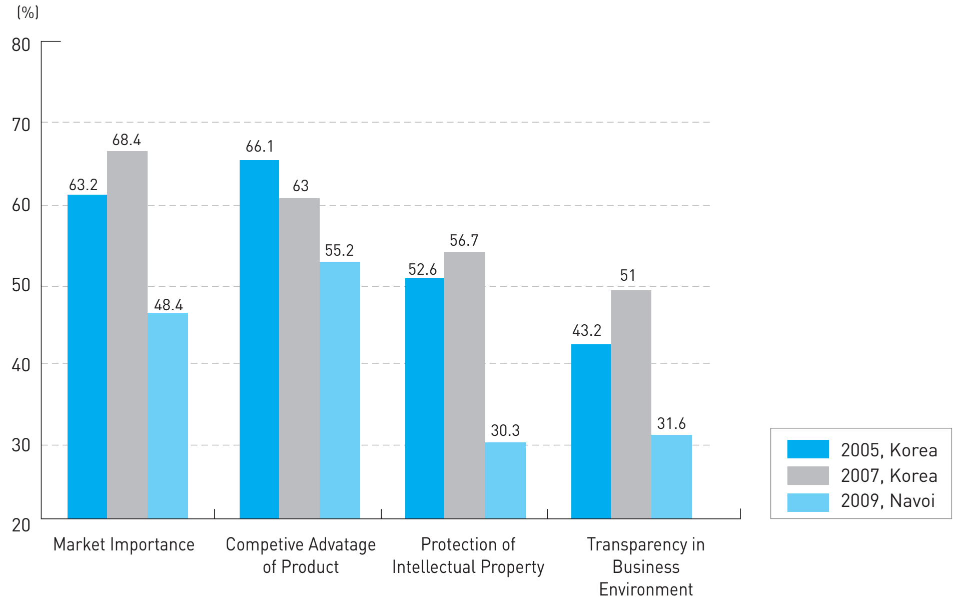
Figure 2-11| Factor Conditions(average 43.7%)



Source : 1. MKE etc, Management Condition Survey of Foreign Invested Company in 2008, February. 2009
2. KDI Questionnaire Survey for Navoi FIEZ Activation, October. 2009

Concerning strategy, structure & rivalry, the score of protection of intellectual property, transparency in business environment were low compared to that of Korea.

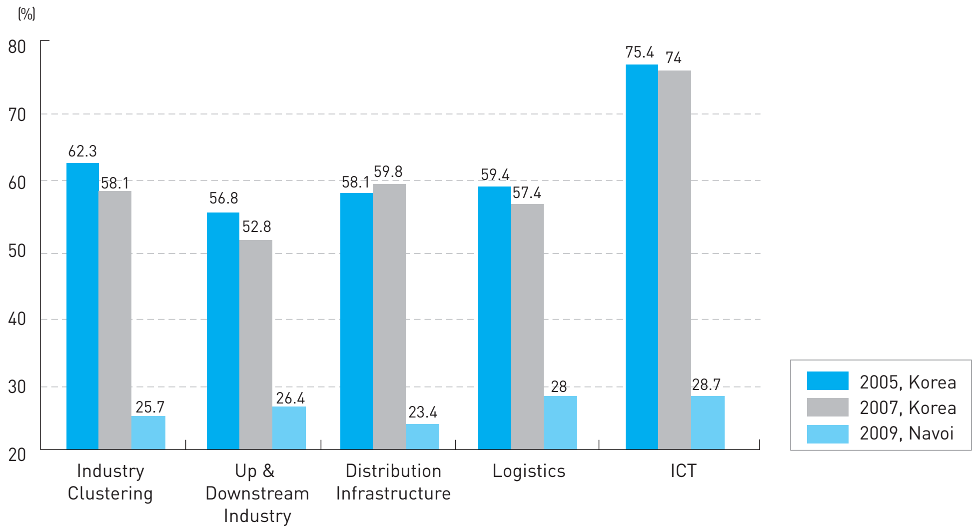
Figure 2-12 | **Strategy, Structure & Rivalry(average 44.0%)**



Source : 1. MKE etc, Management Condition Survey of Foreign Invested Company in 2008, February. 2009
2. KDI Questionnaire Survey for Navoi FIEZ Activation, October. 2009

Concerning related & supporting industries, the average score was only 26.1. All the scores of each category were very low compared to those of Korea.

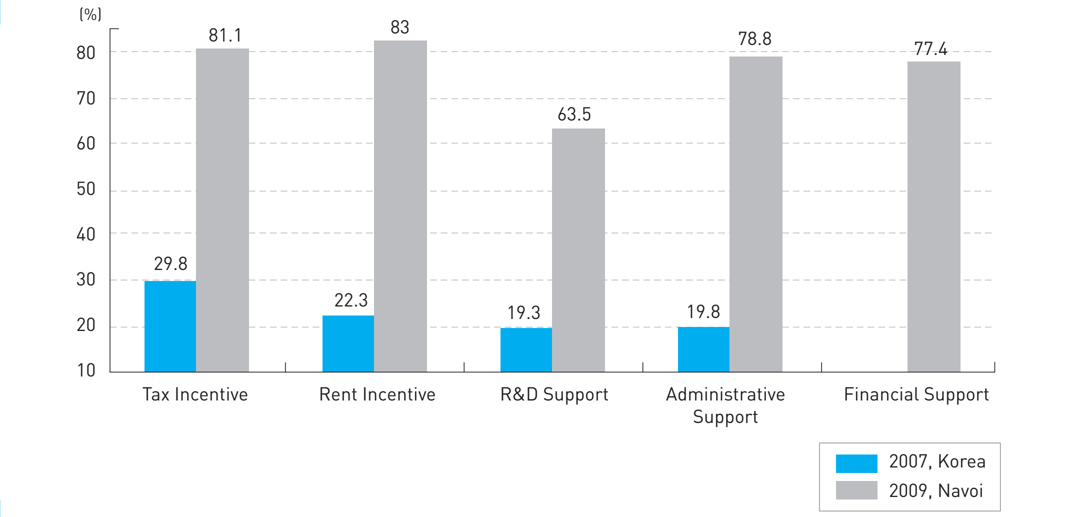
Figure 2-13| **Related & Supporting Industries(average 26.1%)**



Source : 1. MKE etc, Management Condition Survey of Foreign Invested Company in 2008, February. 2009
2. KDI Questionnaire Survey for Navoi FIEZ Activation, October. 2009

The ratio of perception to get an FDI support was high compared to that of Korea in 2007 for all categories.

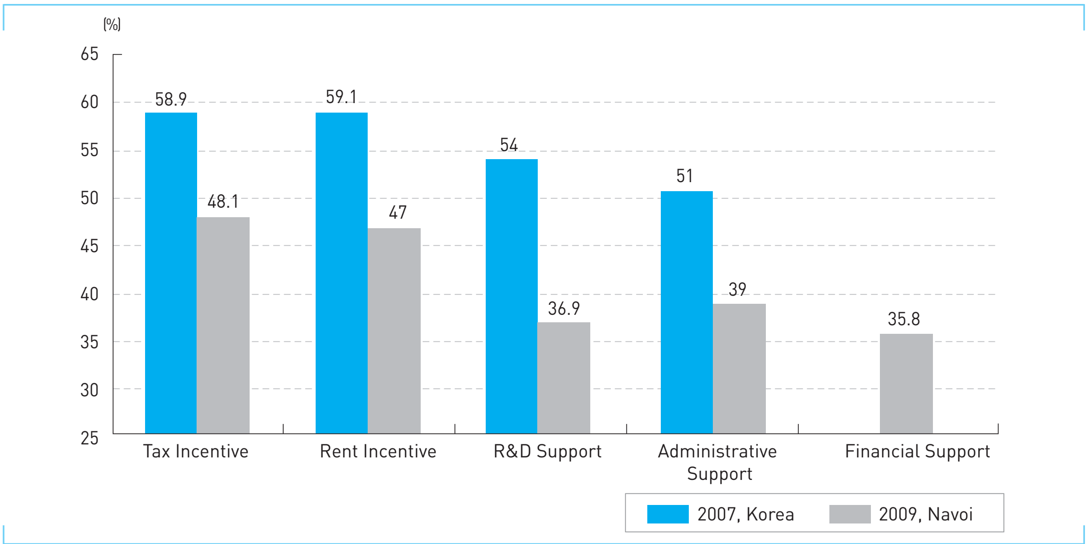
Figure 2-14 | The Ratio of Perception to Get a FDI Support



Source : 1. MKE etc, Management Condition Survey of Foreign Invested Company in 2008, February. 2009
2. KDI Questionnaire Survey for Navoi FIEZ Activation, October. 2009

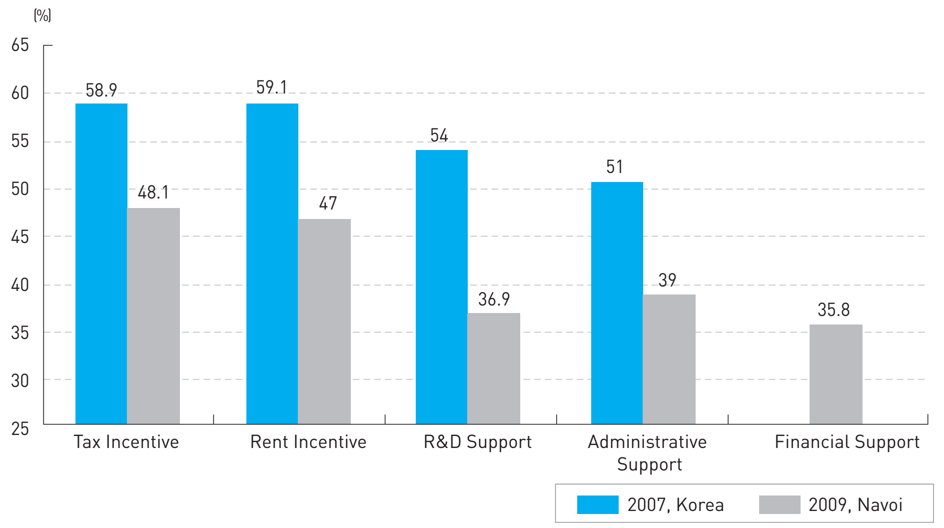
Satisfaction index of FDI support was low compared to that of Korea in 2007 for all categories.

Figure 2-15| Satisfaction Index of FDI Support



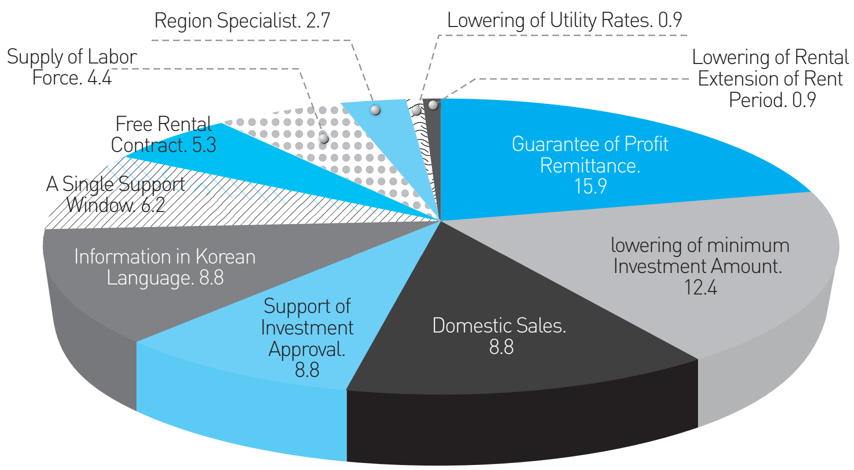
Source : 1. MKE etc, Management Condition Survey of Foreign Invested Company in 2008, February. 2009
2. KDI Questionnaire Survey for Navoi FIEZ Activation, October. 2009

Figure 2-16 | Unnecessary Government Regulation



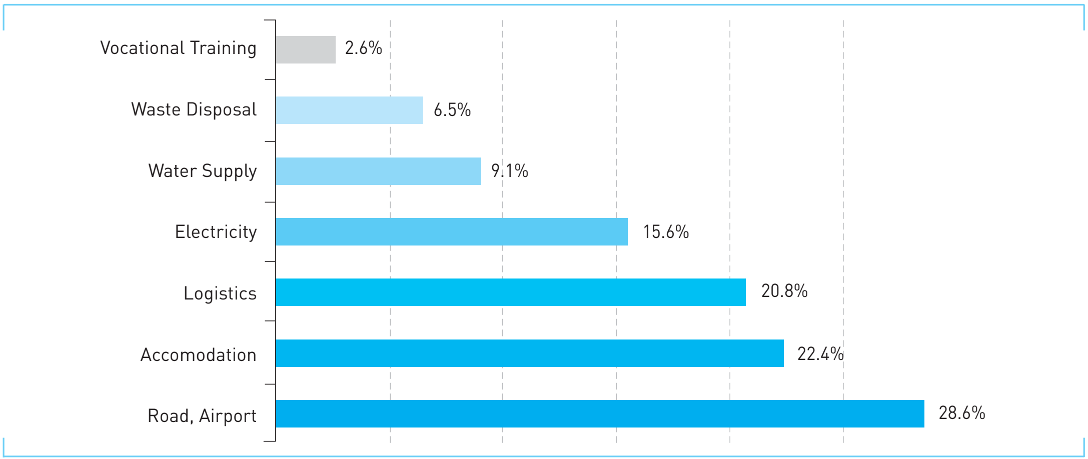
Source : 1. MKE etc, Management Condition Survey of Foreign Invested Company in 2008, February. 2009.
2. KDI Questionnaire Survey for Navoi FIEZ Activation, October. 2009.

Figure 2-17| Suggestions of the Korean Delegation for the Navoi FIEZ



Source : KFSMB, 2009, 7

Figure 2-18| Pre-requisite Infrastructures Needed in Navoi FIEZ



Source : KFSMB, 2009, 7

3.4. SWOT Analysis of Navoi FIEZ

Based on Korean companies' perception on Navoi FIEZ and MKE surveys, this report analyzed strengths, weaknesses, opportunities, and threats of Navoi FIEZ in Table 2-17.

Weaknesses are labor skills, labor supply, supply of raw materials, industry clustering, and up & downstream industry.

Threats are market importance, protection of intellectual property, transparency in business environment, distribution infrastructure, logistics, ICT, government regulation, and macroeconomic & socio-cultural environment, etc.

Table 2-9| SWOT(Competitiveness) Analysis of Navoi FIEZ

S	W
• Labor Cost • Market Size	• Labor Skills • Labor Supply • Supply of Rew Materials • Industry Clustering • Up & Downstream Industry
O	**T**
• Competition Pressure • Test Market to Global Market	• Market Importance • Protection of Intellectual Property • Transparency in Business Environmen • Distribution Infrastructure • Logistics • ICT • Government Regulation • Macroeconomic & Socio-Cultural Environment

Source : SWOT(Strengths, Weaknesses, Opportunities, Threats)

3.5. Selection Process of an Investor in Navoi FIEZ

Selection of investors for allocation in Navoi FIEZ is carried out in two stages(source: www.navoi-fiez.com):

At the first stage of selection the investor submits to the Directorate of Navoi FIEZ a filled investment application for allocation of production on the territory of Navoi FIEZ in the form attaching to it:

- copies of the certificate of the state registration of the investor or an extract from the trading register at the place of registration of the legal entity, legalized in established procedure by the Council office of the Republic of Uzbekistan;
- business-plan of the offered project(requirements to business-plan);
- acknowledgement of business experience of the legal entity in the corresponding sphere, information on similar projects implemented in the corresponding sphere;
- conclusions of an auditor organization on the financial reporting for the period of existence of the legal entity, but not less than for last three years;
- document, confirming samples of signatures of the authorized persons of the investor.

All documents are submitted by investors to the Directorate of Navoi FIEZ with its translation into state or Russian Languages certified in established procedure(source: www.navoi-fiez.com).

The Directorate of Navoi FIEZ within 5 working days considers the submitted documents on conformity to the requirements.

At the second stage investment applications, documents submitted by the investor, are transferred by the Directorate of Navoi FIEZ to the working body of Administrative Council(Ministry for Foreign Economic Relations, Investments and Trade) enclosing the corresponding conclusion signed by the director of the Directorate.

At decision-making on selection of the investor Administrative Council considers:

- financial and technological solvency of the investor;
- general economic efficiency and expediency of implementation of the project(optimum allocation of the capacities, workplaces to be created, influence on structural transformations in the branch, use of existing capacities, presence of necessary raw materials and infrastructure);
- opportunities and prospects of selling of finished goods both in internal and foreign markets;
- Level of localization of production and change of commodity position of finished commodities in HS code in comparison with initial raw materials at a level of one of the first 4 signs;

- conformity of the level of the technological equipment to the modern quality standards(ISO 9001 and ISO 14001), presence of quality control system of in the project meeting the international standards;
- completion of the staff of the enterprise to be created with citizens of the Republic of Uzbekistan not less than 80 percent of the total quantity of employees, with granting opportunity to pass training and improve qualification;
- volume of direct investments;
- other factors determined by resolution of Administrative Council.

At consideration of investment applications, preference is given to the projects providing full cycle of production on the territory of Navoi FIEZ through creation of legal entities cooperating in consecutive technological processing of raw materials and semi finished items in production of finished goods(source: www.navoi-fiez.com).

Administrative Council considers investment applications within 10 working days.

The positive resolution of Administrative Council on the investment application is formalized in a session report of Administrative Council and is the basis for the conclusion between the Directorate of Navoi FIEZ and the investor of the Agreement on investment on the territory of Navoi FIEZ.

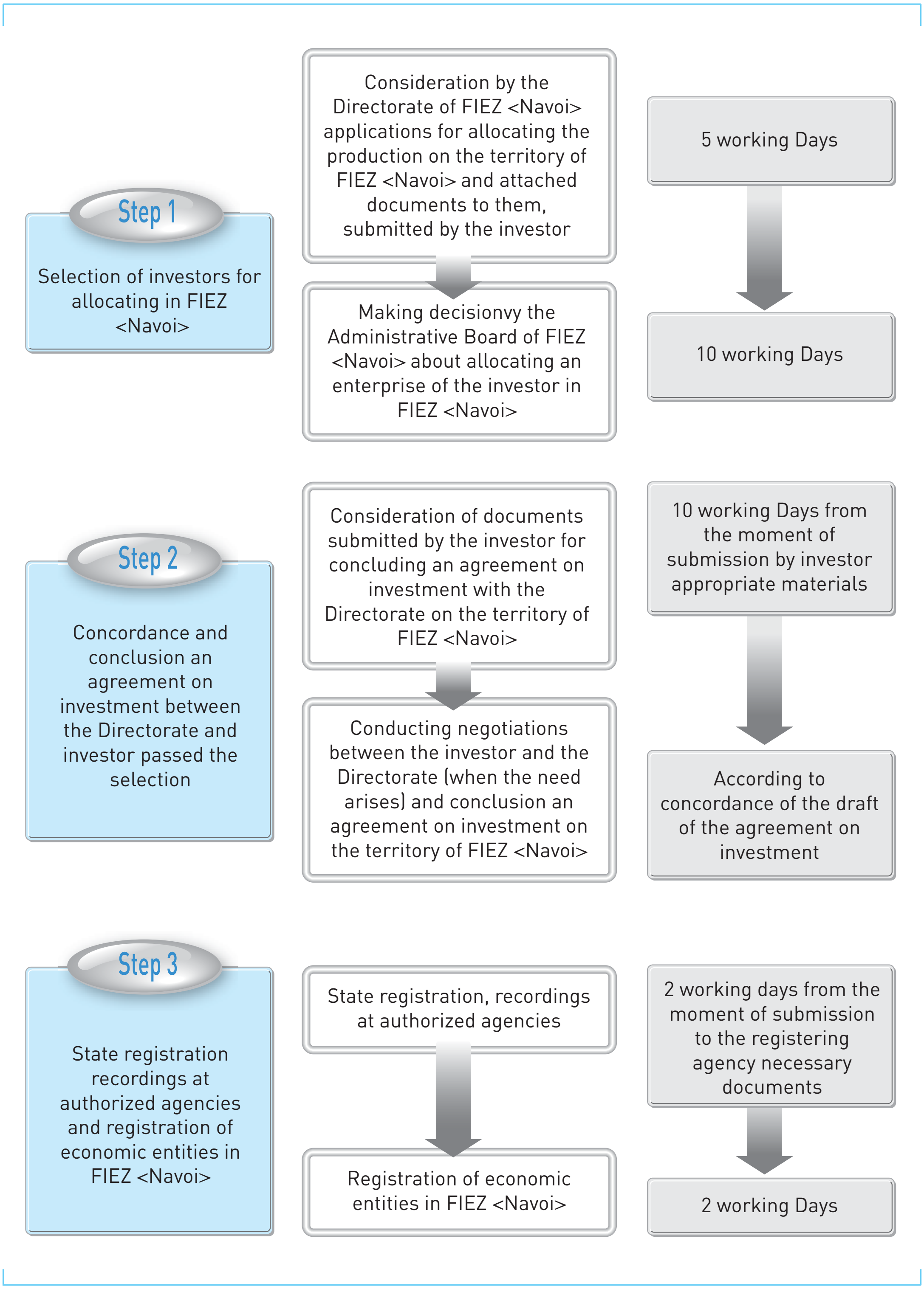
A copy of the session report with the resolution of Administrative Council is transferred by the working body to the investor or his authorized person within 3 working days from the date of validation of the report of Administrative Council.

The investor is responsible for reliability of submitted data and documents, timely, full and appropriate execution of the obligations in the order established by legislation.

Members of Administrative Council, the working body and the Directorate of Navoi FIEZ are responsible in accordance with legislation for disclosure of confidential information, untimely and poor-quality consideration of investment applications and the materials attached to them.

You can read more on selection of investor to Navoi FIEZ in Regulations on the order of selection of investors for allocation in Navoi FIEZ(source: www.navoi-fiez.com).

Figure 2-19 | **UZINFOINVEST'S Procedure of an Enterprise as Participants of Navoi FIEZ**



Source : www.navoi-fiez.com

3.6. “UZINFOINVEST” the Information Support & Foreign Investments Promotion Agency

UZINFOINVEST was established by the initiative of the President of the Republic of Uzbekistan Islam Karimov with the primary purpose of providing a one-stop informational and all other possible support to foreign investors in Uzbekistan.

Agency is an independent institution(legal entity) under the Ministry of Foreign Economic Relations, Investments and Trade(source: www.uzinfoinvest.uz).

Main Goals:

- Further enhancement of process of foreign and domestic direct investments attraction.
- Broader disseminations abroad of information about investment opportunities in Uzbekistan.
- Wider informing of foreign businesses about advantages of investment environment created in the republic.

Main Tasks:

- Increasing awareness and carrying out explanatory works among foreign businesses and mass media about economic and resource potential of Uzbekistan and favorable conditions created in the republic for attraction of foreign investment.
- Information support of the foreign investors, providing them with information about prospective projects, legislation regulating investment activity, including provided incentives and preferences for investment projects implementation in Uzbekistan.
- Organization of meetings and negotiations between foreign investors and domestic businessmen for implementation of mutually beneficial projects in Uzbekistan.
- Forming and supporting positive international image of Uzbekistan by carrying out promotional events abroad(exhibitions, forums, presentations, conferences and workshops), publishing special literature, leaflets and creating special informational web-site.

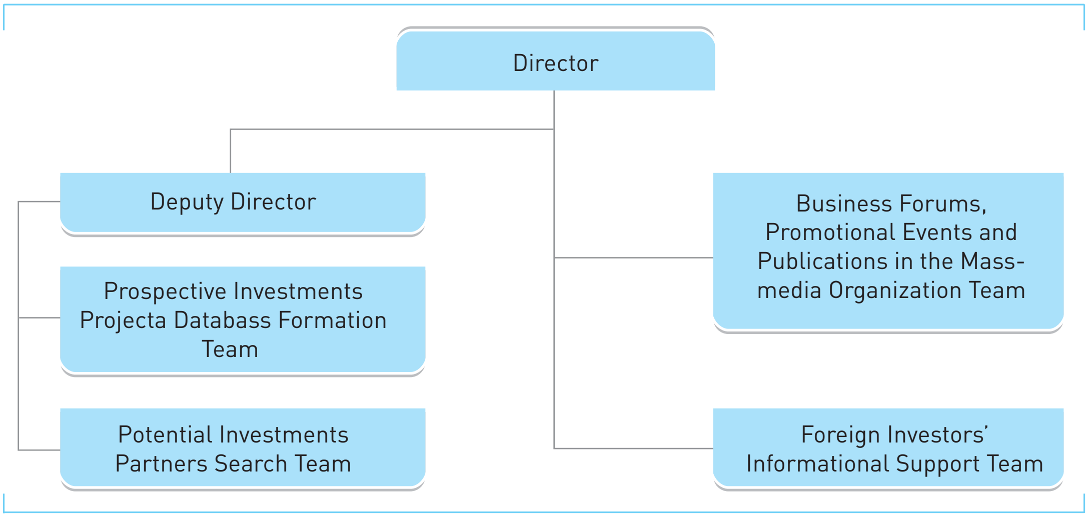
Functions and Activity:

- Participation in working out of proposals on improvement of legislation of Uzbekistan in the field of foreign investments attraction;
- Through organization of promotion evens attracting FDI, foreign credits for implementation of important investment projects;
- Information support of investors about attractiveness of investment to the appropriate sectors of economy and regions of Uzbekistan;
- Participating in forming of portfolio of prospective investment projects;
- Preparation of proposals for determination of list of priority economy sectors for attracting FDI;

- Creating and updating electronic data base of investment proposals;
- Carrying out comparative analysis of investment environment in foreign countries and working out recommendations on improving investment environment in Uzbekistan;
- Cooperation with other investments promotion agencies of foreign countries;
- Posting information and advertisement about export and investment opportunities in foreign mass media;
- Organizing investment and business forums, round tables, conferences, exhibitions etc;
- Assisting in carrying out visits of investors to Uzbekistan;
- Creating and updating investment web-site;

Performing other duties assigned by Minister FERIT instructions.

Figure 2-20 | UZINFOINVEST'S Structure



Source : www.uzinfoinvest.uz

4. Suggestions

Clear goal- setting of foreign investments in flow, in detail

The Uzbekistan government should set specific goals regarding the foreign investments inflow. The goal for 2009 should be USD 900 mln.(30~40 projects), production outlook of USD 1.5 bln., and export of up to USD 1.0 bln. For 2010, the goal should be USD 5.5 bln.(100~120 projects), production outlook of USD 7.5~8 bln., and up to USD 5.0 bln. in exports(Source: H. E. Elyor Ganiev, Free Industrial Economic Zone in NAVOI: New Investment Opportunities for Korean Partners in Uzbekistan, March. 2009).

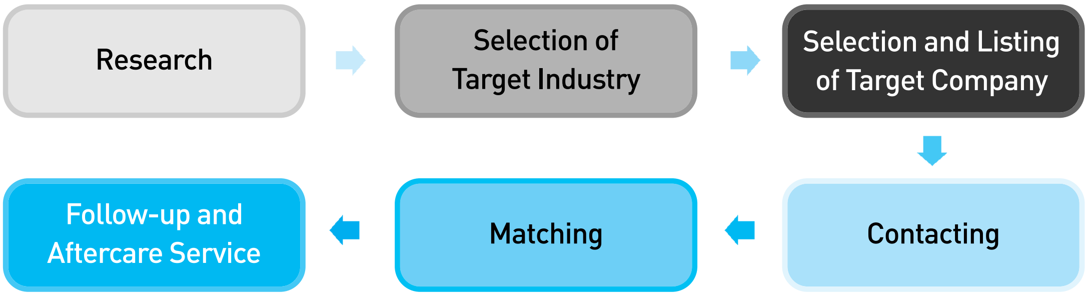
Having set a clear goal, cascade that goal by industry, country, investment quantity, factory size, etc. Then action plan must be laid according to 5W1Hs; what, why, when, who, and how.

Formulate a long-term, mid-term, short-term FDI promotion strategy

Formulate a long-term, mid-term, short-term FDI promotion strategy and make sure that each strategy is linked to one another.

Structure system of FDI promotion

FDI promotion should be structured in the order of research, selection of target industry, selection and listing of target companies, contacting matching, and finally follow-up and aftercare service.



Improve the foreign investment environment and competitiveness

A better investment environment and competitiveness can be achieved through tailor-made incentive packages such as strategic target company, pioneer status award and according to FDI seeking such as market-seeking, resource/asset-seeking, efficiency seeking etc. Incentive on tax, rent, R&D support, administrative support, financial support is another way to improve the investment environment. Industry clustering, up & downstream(related) industry, better labor skills and supply, better supply of basic raw materials will also enhance the environment and competitiveness. Transparency in business environment and government deregulation, distribution of infrastructure and logistics and ICT, and finally a macroeconomic & socio-cultural environment will also help better the investment environment and competitiveness.

Organize investment promotion process according to ‘plan-do-see’ cycle

The Invest Korea is composed of three divisions: Strategic Investment Planning

Division(investment Planning, investment PR, investment research & analysis), Investment Promotion Division(industry, investment partnership support), and the Foreign Investor Support Division(investment administration, investment consulting, investment service).

Make a bridge among related institutions and investors

Invest Korea acts as a bridge between investors and local/central government according to policy formulation, activities to attract investment, administrative support. The Uzbekistan government should specify the activity scope of Administrative Board of FIEZ Navoi, Directorate of FIEZ Navoi, MFERIT(Ministry of Foreign Economic Relations, Investments and Trade), UZINFOINVEST etc.

Communication (PR) is most important

- Information is the key: gathering and providing proper information will make a big difference
- Devise PR strategy from the investor's point of view: the investor is the customer
- Communicate with investors: interact with them to get to know them
- Hire a professional PR agency: PR agencies are expensive, but such investment will pay off in the end
- Hire foreign staff and pay them well: foreign insight will make a big difference for PR strategies
- Language ability is very important: continue to study foreign languages and hire capable employees
- Depoliticize FDI: attracting FDI is not about promoting personalities, it is about promoting the country
- Avoid exaggerations and be credible: Make your region a "hub" before you start calling it a "hub"
- Benchmark: Identify countries successful at attracting FDI and go see how they do it
- Rank PR activities by priority: What should money be spent on and what is less important?
- Identify and promote synergy opportunities: The chance for strategic tie-up scan make a big difference
- Understand and promote your region's strengths: Not all investment is suited for all regions
- Make a long term PR strategy: Analyze how PR activities will proceed over the next several years
- Cooperate to devise strategies: Other regions have more experience, share information and benefit from it.
- Prioritize PR: What should money be spent on and what is less of a priority?
- Understand the importance of being unique: FDI will come if there is a niche

Structure the system to perform one-stop service

- Investor Support Center(ISC) within Invest Korea Plaza provides information and assistance on a variety of matters relating to foreign investment and daily living in Korea, from selecting plant sites and forging alliances with Korean partners, to education and accommodation
- Additional business- related assistance will be provided by officials seconded from the Ministry of Justice, the National Tax Service, the Korea Customs Office, and the court of law, all of whom offer a broad range of administrative support and respond to complaints made by foreign investors. All services provided by the ISC and available in English , Japanese and Chinese.
- There are experts that
  - conduct research and provide information about Korea as a business location ,
  - assist investors in identifying emerging investment opportunities,
  - answer questions on tax and accounting, and legal issues,
  - advise investors on how to take advantage of tax incentives,
  - offer free analysis service to investors,
  - help investors identify potential joint venture partners,
  - offer comprehensive service for the entire investment process including administrative issues,
  - handle civil affairs in 11 areas including visa tariff, and tax,
  - coordinate meetings with relevant authorities and official institutions, and
  - resolve difficulties experienced by investors in the course of doing business through the Investment Ombudsman

Improvement of one-stop service

According to Invest KOREA's One-stop Service, investment promotion process is described in detail such as 4 categories of investment marketing, investment administrative support, investment monitoring, post-investment management, 9 levels of project management of promotion, inquiry, investor's visit, delegation support, search for investment project, support for visiting investor, investment notification, arrival of investment funds , aftercare service and relevant department.

	9-Levels of Project Management	Details
Investment Marketing	·Promotion	· Conduct surveys · On/offline consultions · Begin process of contacting investor
	·Inquiring	· Furnish tailo-made investment information to investor
	·Investor's visit	· Visit potential investor · Step up intensity of consultions
	·Delegation support	· Investment promotion delegations · Dispatch of investment promotion task force
	·Search for investment project	· Verify contents of investment project

Investment Administrative Support	· Support for visiting investor · Investment notification	· Induce visit by investor to Korea · Maintain support for investor's Korea visit · Official notification of investment
Investment Monitoring	· Arrival of investment funds	· Confirm arrival of investment funds
Post-Investment Management	· Aftercare servic	· Resolve business bottlenevks · Promote reinvestment · Promote improvements to the domestic investment environment

Service provided at each support stage

Different service should be provided at each stage of support.

Research and consulting for potential investors	· Provide expert consulting service for potential investors
Investment project support	· Assing project manager to major project and provide comprehensive service · Help to find business partners
Administrative support service	· FDI notification & registration · Deal with civil affairs directly(immigration, taxes, customs, etc.)
Settlement support & aftercare service	· Settlement support service · Provide aftercare and trouble-shooting services

Periodical poll and survey of foreign invested companies' management and business environment in Navoi FIEZ

Periodical polls and surveys should be conducted regarding the management of foreign invested companies and business environment in Navoi FIEZ. Such polls and surveys are to analyze the management performance of foreign investors' companies and the management environment of FDI, and thus improve FDI management environment.

APPENDIX: Case Study of Korea's FDI and National IPA (Investment Promotion Agency)

The following section is a Case Study of Korea's FDI environment, National Investment Promotion Agency, Key Success Factors, trends, promotion strategies of Korea's FDI that could provide applicable references for the Uzbekistan government.

The contents of the following section are excerpts from Korea Trade-Investment Promotion Agecny (KOTRA) and more information can be found from www.investkorea.org and www.i-ombudsman.or.kr.

1. Deciding Factors of FDI in Korea

1.1. World-Class Human Resources

Fervent Zeal for Education and Achievement

Koreans have earned a global reputation for their educational fervor. The strong commitment to learning has often been cited as the secret behind Korea's surprising overnight transformation into the world's 9th largest trading nation in 2009. According to the IMD World Competitiveness Yearbook 2008, the percentage of the Korean population aged 25-34 that has attained at least tertiary education is as high as 53 percent. This is above the corresponding figures for most OECD nations, excluding Japan and Canada, which tend to linger in the 40-percent range, effectively testifying to the never-ending desire for higher education among Koreans.

Passion for Work

Industriousness is a feature as distinctively Korean as educational fervor. Korea topped OECD economies in GDP growth per working hour over the period between 2001 and 2006, second only to Slovakia, according to the OECD Productivity Database as of December 2007. Moreover, the growth rate of labor productivity in Korea posted 4 percent and 5.4 percent?in 2006 and 2007 respectively, which far exceed 1.6 percent and 1.4 percent on OECD average, and is the?third highest level in the world.

Growing Participation by Women in Work Places

In the past, the presence of women at work places was disproportionately low in Korea compared to their male counterparts. This has changed, however, thanks to related government policies. According to the Ministry of Education, Science and Technology, women have represented over half of Korean college graduates for over the past decade and accounted for more than 40 percent of post-graduate degree holders since 2006(42 percent as of 2008), and the percentage is gradually on the rise.

Table A-1 | Korea's World-Class Human Resources

High Educational Zeal and Achievement

- 51% of Koreans between 25-34 have attained post-high school level education
- Korean students make up the largest group of foreign students in U.S. and China

Technological Competitiveness

- The information technology skills of Koreans rank in the top three globally
- Korean ranks 3rd in patents granted to residents and 2nd in patent productivity

Information Technology Skills(2007)*

01	Iceland	9.39
02	Israel	9.28
03	Korea	9.07
04	Singapore	8.85
05	Finland	8.80

* Based on a scale of ten

Higher Education Achievements(2006)*

01	Singapore	56.70
02	Canaga	55.00
03	Japan	54.00
03	Korea	53.00
13	Hong Kong	40.50
14	U.S.A	39.00

* Percentage of population that has attained at least tertiary education for persons 25-34

Source : IMD World Competitiveness Yearbook-updated in Nov, 2008.

1.2. Sophisticated Domestic Market

A Vast Domestic Market with Sophisticated Consumers Driving Demand

As the world's 15th largest economy in terms of GDP and home to 50 million people, Korea offers an attractive marketplace for international investors. Along with its large, fast-growing economy(average annual GDP growth of 4-5 percent) as evidenced by the fact that over half of the Global Fortune 500 firms have already established their business presence in Korea(245 companies as of 2008), the broad base of sophisticated consumers with a strong purchasing power is another factor that makes companies turn to Korea for a lucrative market.

A Big Trading Nation

Values of Korean imports and exports in 2008 totaled US$435 billion and US$422 billion respectively, equivalent to 47 percent and 45 percent vis-a-vis GDP. Korea is the world's 9th largest trader in 2009 with imports and exports accounting for nearly 90 percent of the country's GDP. Korea ranked 9th in the world in terms of global export market share based on 2009.

Table A-2 | Korea's Sophisticated Domestic Market

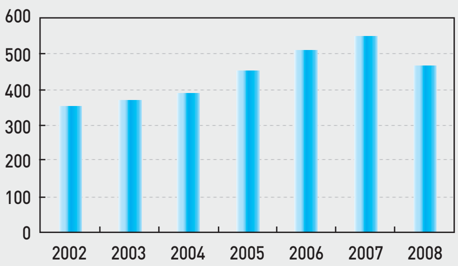
Large Market with Sophisticated Consumers

- Home to 49 million people(2008)/World's 13th in GDP)2007)
- Early adopters as a test market for new products
- The buying power of Korea's brand-savvy consomers is increasing quickly
- The presence of over half of Global Fortune 500 firms

A Big Trading Nation

- Trade with Asian neighbors accounts for over half of Korea's trade volume
- China, U.S.A. and Japan are Korea's largest trading partners
- Korea trades with over 220 countries

Final Private Consumption Expenditure9US$ billion)



YEAR	USS bn
2006	510
2007	551
2008	469

Source : Korea National Statistical Office

1.3. Global Leading Industries

Dynamic and Competitive Market Players

Korea-based firms have competitiveness on the global stage with growing popularity in international business. Korean companies have achieved top global market shares in shipbuilding, DRAM semiconductors and TFT-LCD displays, mobile phone, and count themselves among the top five in automobiles, steel, petrochemicals, textiles and consumer electronics. Fourteen Korean firms made the 2009 Fortune Magazine's Global 500: Samsung

Table A-3 | Korea's Global Leading Industries

The global competitiveness of Korea's industries ranks high in terma of the country's attractivenessto international business.

*As of 2008

Semiconductors

- Samsung Electronics and Hvnix rank 1st and 2nd with 50% share of the world's DRAM market.
- Succeeded in developing 40 Nano DRAM for the first time in the world, will stsrt production from 3Q, 2009.

Shipbuilding

- Korean shipbuilders ranked 1st globally in terms of new orders(40%), order backlogs(36%) and volume of vessels built(37%) of all orders worldwide.

Automobiles

- World's 5th biggest producer for 4 consecutive years
  - 4,086 and 3,827 thousand units in 2007 and 2008 respectively

Displayd

- No. 1 market share in LCD, PDP, OLED and CRT-LCD: 46.1%, PDP: 52.3%, OLED: 45.3%
- Major players: Samsung Electronics, Samsung SDI, LG Display, LG Electronics

Source : Kotra, Investing in Korea 2009

Table A-4 | Korea's Other Major Industries

Other Major Industries

Steel(2007)

World's 6th Biggest Producer

Steel Export/GDP = 2.3%
Steel Export/Total Export = 5.2%

(Unit: 1,000 tons, %)

Year		World	Korea
1995		744,599	36,772(4.9)
2000		847,662	43,107(5.1)
2006		847,662	48,455(3.9)
2007		1,344,085	51,517(3.8)
Annual Increase Rate	1995~2000	2.6	3.2
	2000~2007	6.7	2.3

Source : International Iron & Steel Institute Korea Iron & Steel Association
Notes : 1) Based on the production of blister steel
2) ( )means the percenage of the world's production

Petrochemicals

World's 3rd Biggest Producer

New Industries potentially able to grow combined with petrochemicals such as energy, environment, Bt, and NT are expanding

(Unit: US$ MN, %)

Year		Export	Import
1990		403	2,197
1995		1,184	4,358
2000		1,789	4,902
2004		2,817	7,573
2005		3,207	8,876
2006		3,798	10,482
2007		4,456	12,514
Annual Increase Rate	2006~2007	17.3	19.3
	2007~2009	15.1	10.7

Source : Korea Customs Service

Source : Kotra, Investing in Korea 2009

Electronics, LG, Hyundai-Kia Motors, SK, Samsung Life Insurance, POSCO, Korea Electric Power Corporation, Kookmin Bank, Hanwha, KT, Samsung, Hyundai Heavy Industries, SK Networks, and S-Oil.

1.4. Superior Logistics

Incheon International Airport, the Center of Transportation in Northeast Asia

The Incheon International Airport served 63 airlines and 30 million passengers traveling to 161 cities in 49 countries as of 2008. By handling 2.42 million tonnes of international cargo, Incheon International Airport became the world's second largest airport in terms of cargo throughput in just six years after its opening in 2001.

The Incheon International Airport won the World Best Airport Award for the fifthh consecutive years from 2005 to 2009 Airport Service Quality evaluation by Aiports Council International. As the second phase of a multi-stage airport expansion project was completed in June 2008, the airport now has a 4,000m runway that enables landing and takeoff of super jumbo passenger aircraft such as Airbus 380.

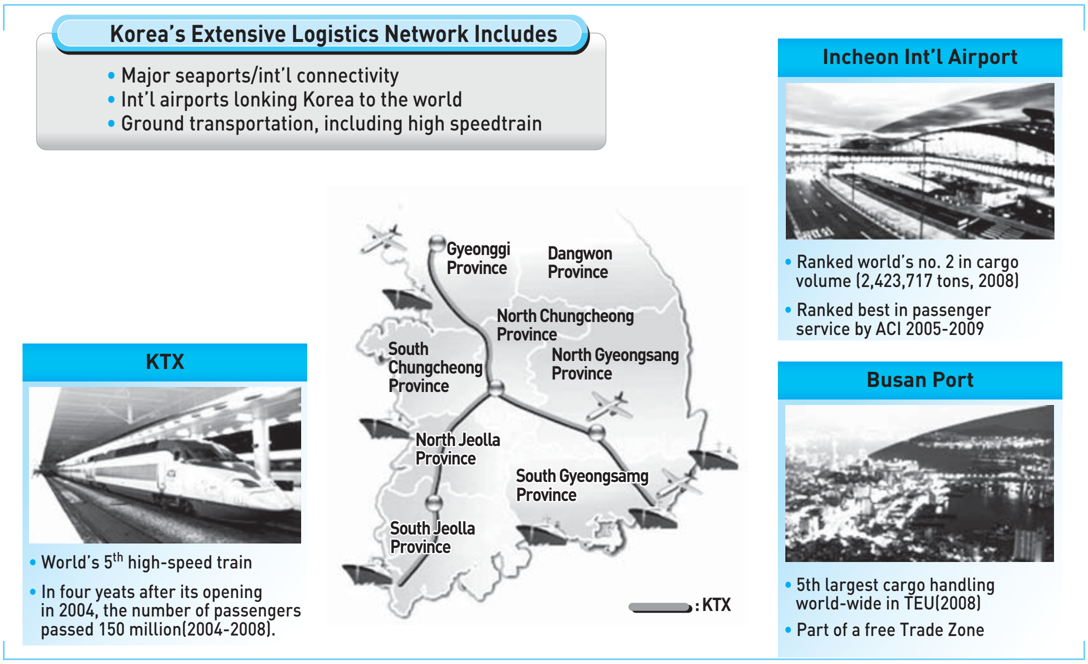
Strategically Located Ports and Harbors

The port of Busan is the world's fifth largest container port, having handled a throughput of 13,450,000 TEU in 2008. Located on the trunk route to and from Europe, Asia and North America, the port has the potential to grow into a major global logistics center connected to the entire Eurasian continent from China, Russia and Mongolia to Central Asia and Europe, if a trans-Korean railway begins serving the peninsula end-to-end. Furthermore, Busan New Port, 25km away from the Busan port, and Gwangyang port in southwetern Korea have been developed into super-sized container ports equipped with state-of-the-art automation systems. The two ports have been designated as free economic zones, which are expected to emerge as the center of global logistics and business by promoting foreign investment through various tax-related.

High-Speed Rail System and Trans-Korean Railway

In 2004, Korea's high-speed railway lines linking Seoul and Busan, and Seoul and Gwangju were brought to completion, making Korea the fifth country in the world to establish a bullet train system after Japan, France, Germany, and Spain. The second phase construction project for a Seoul-Busan line by 2010 and Seoul-Mokpo line by 2017 is expected to connect the eastern and western axes of the peninsula with high-speed lines upon completion, making the entire country accessible within a few hours.

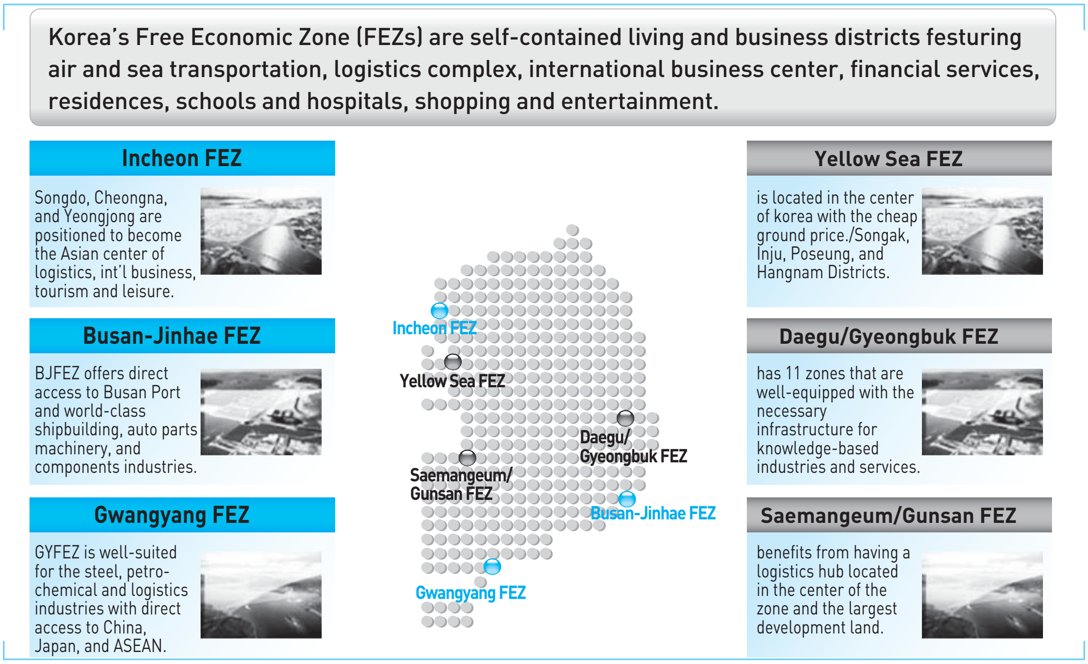
Figure A-1 | Korea's Superior Logistics



Source : Kotra, Investing in Korea, 2009

1.5. Free Economic Zones

Figure A-2 | Korea's Free Economic Zones



Source : Kotra, Investing in Korea, 2009

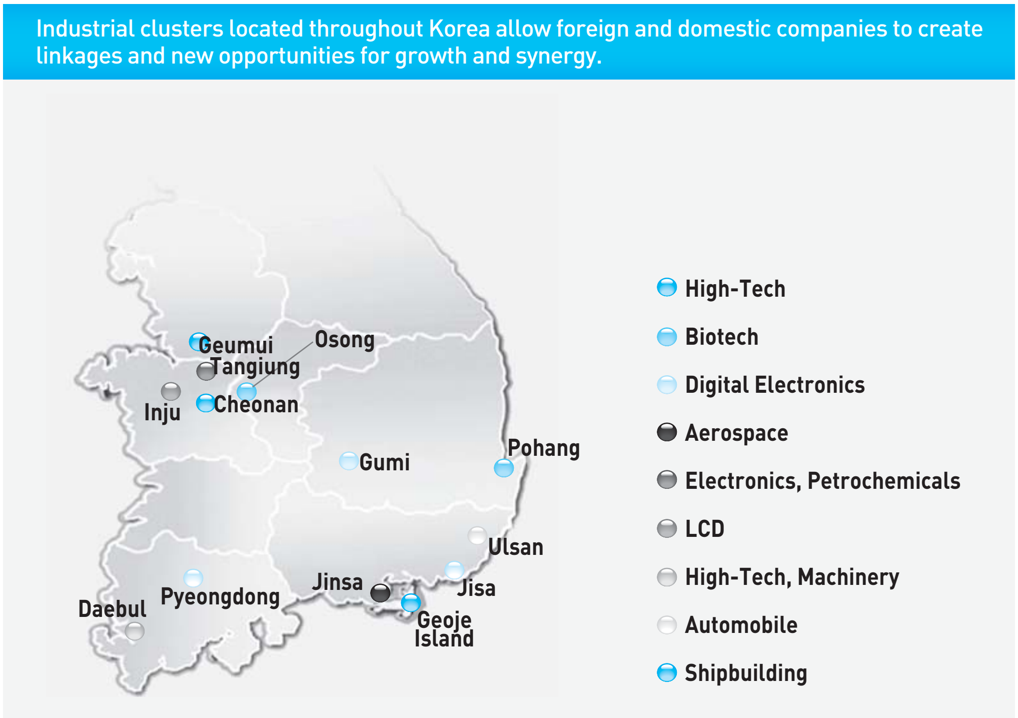
1.6. Advanced Technologies and High-Tech Clusters

Technological Competitiveness

Korea has demonstrated impressive track records in patent related indices, as reported in the IMD World Competitiveness Yearbook 2007. Korea ranked at the top globally in terms of patent productivity corresponding to the number of patents vis-a-vis R&D workforce. Korea came in third in information technologies after Iceland and Israel.

Korean workers are as highly skilled in non science/IT fields. Korea's shipbuilding and electronics industries and fast-growing automotive industry are all technology-intensive manufacturing sectors. Notably, the stunning strides made by the Korean shipbuilding industry in recent years have been the result of bold facility investment coupled with a highly-skilled labor force and an extended period free of labor disputes.

Figure A-3 | Korea's Industrial Clusters



Source : Kotra, Investing in Korea, 2009

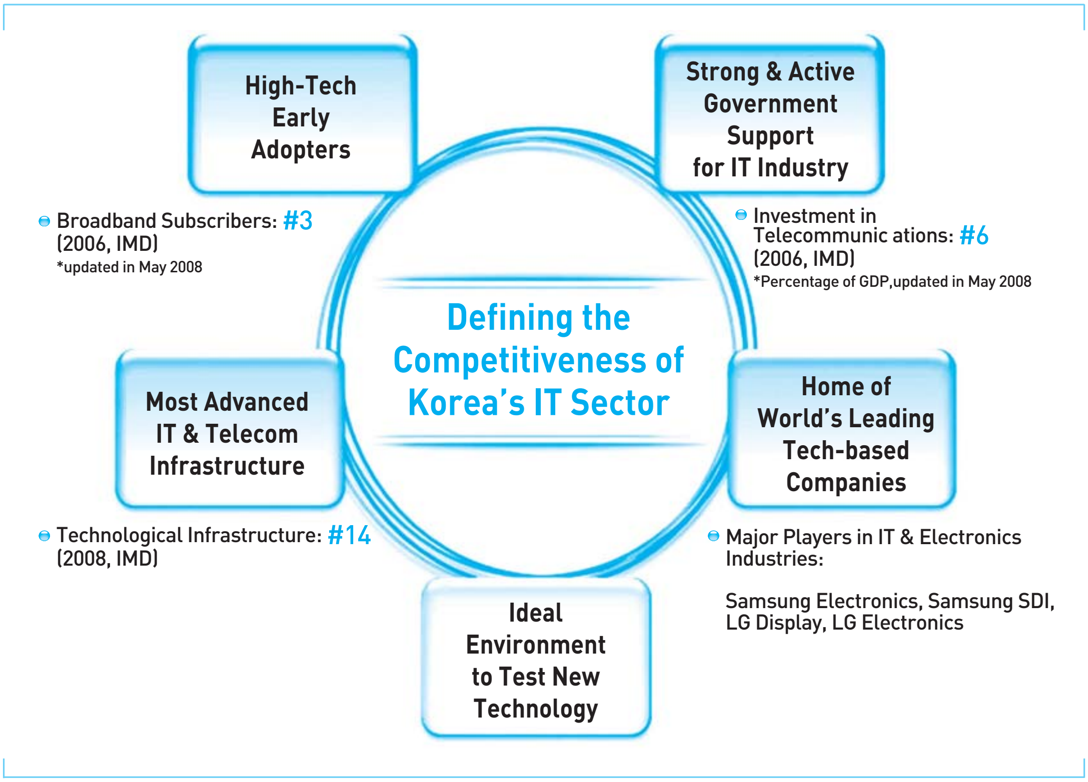
1.7. ICT Competitiveness

ICT Wonderland

Korea was ranked at the top for the third consecutive years from 2005 to 2007 in the digital opportunity index(DOI) published by the International Telecommunication Union. DOI gauges the extent of IT development based on comprehensive analyses of indicators including Internet penetration rate, telecommunications spending-to-income ratio, and rate of Internet use.

Korea is highly competitive on the ICT front. WiBro or Wireless Broadband(Mobile WiMAX), WCDMA HSPA, terrestrial DMB, FTTH WDM-PON, standard embedded software integration technology, digital actor system, low-power SoC(System on Chip) for interactive DMB, voice recognition navigation system, etc. are some of the country's impressive technologies. These innovative technologies are expected to succeed Korea's CDMA technology, estimated to have generated KRW 56 trillion in economic gains, and serve as a powerful new growth engine for the country's ICT sector.

Figure A-4 | Korea's ICT Competitiveness



Source : Kotra, Investing in Korea, 2009

2. Trend of FDI in Korea

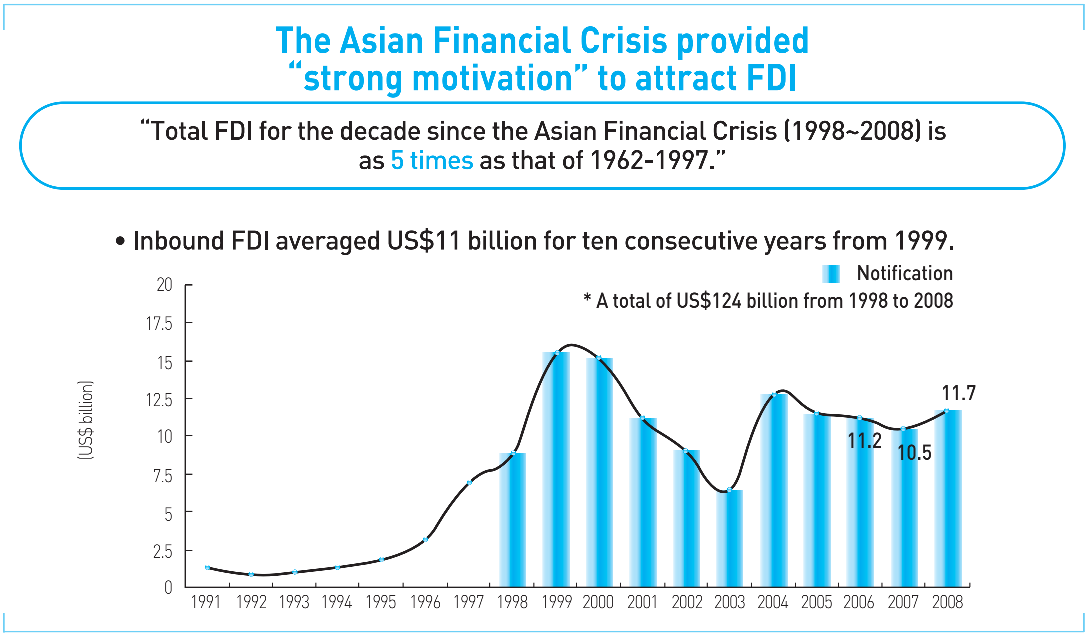
2.1. FDI Trend(from 1997 financial crisis to 2009)

Korea has opened the capital and property markets in a bid to further liberalize the economy and actively promoted foreign direct investment through the enactment of the Foreign Investment Promotion Act(FIPA) since 1998 in the wake of Asian financial crisis. The government-wide effort to overcome the financial crisis through FDI promotion resulted in success thanks to the then booming global economic environment.

In the aftermath of 9.11 terrorist attacks and dot.com bubble burst in 2001 in the U.S., however, FDI had plunged from its peak in 2000 until 2003. After the rebounded in 2004 followed by government announcement of the comprehensive plan for foreign direct investment in 2003, FDI continued to increase by 2008, posting USD 10 billion in cumulative FDI for the fifth consecutive years. As a result, cumulative FDI over the period from 1998 to 2008 amounted to five times the cumulative FDI from 1962 at the initial stage of Korean industrialization to 1997 in the onset of the Asian financial crisis, which proves that FDI is a major force driving the Korean economy.

On average, annual FDI amounts to USD 11billion, with the share of Greenfield investment expanded to 61.7% in 2006, 76.4% in 2007, and 62.2% in 2008. However, investment through

Figure A-5 | Korea's Inbound FDI



Source : Kotra, FDI Trends in Korea(1998-2009), 2009

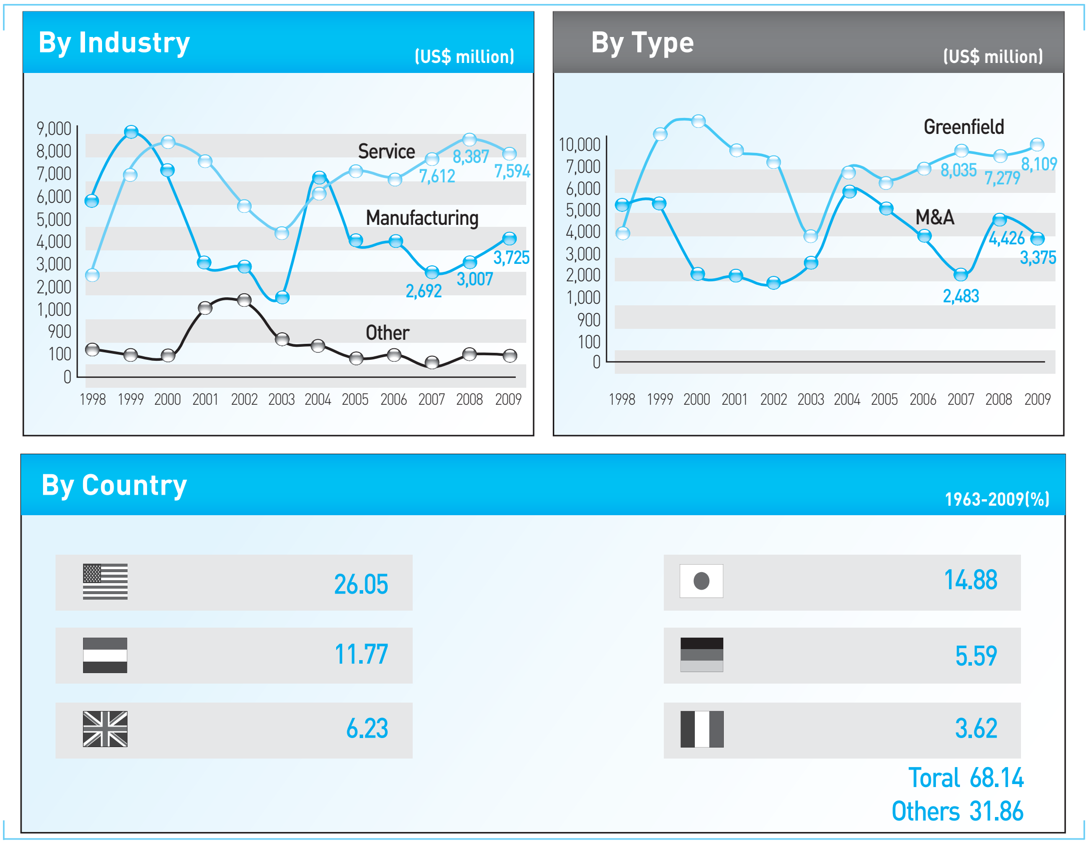
M&As, rather than Greenfield investment, is expected to rise given the current trend of business consolidation, which indicates the need for institutional frameworks to facilitate and support merger and acquisition.

2.2. FDI by Industry

The manufacturing sector accounted for 25.6 percent of total FDI in 2008, while the services industry took up 71.9 percent. FDI in 2008 did not exhibit major changes compared to 2007.However, in the latter half of 2008, a massive investment was made in the services sector, finance and insurance sector in particular, posting a 10.2 percent year-on-year growth to USD 8.39 billion. FDI in the services industry was on a steady increase, bouncing from the decline in 2006.

Meanwhile, FDI in food, non-metal, chemical engineering industries of the manufacturing sector hiked in 2008. Investment in parts and materials business reached USD 2.54 billion, representing 84.5 percent of FDI in the entire manufacturing industry.

Figure A-6 | **Korea's FDI Trend**



Source : Kotra, FDI Trends in Korea(1998-2009), 2009

2.3. FDI by Region

FDI from the EU, U.S., and Japan accounted for 77.6 percent of total foreign investment in Korea as of 2008, with the EU taking up 54.1 percent(USD 6.36 billion). The union has been the largest foreign investor, with its share standing at 46.5 percent in 2006 and 43.9 percent in 2007. Major European investors include the U.K., the Netherlands, Germany, France, etc.

Meanwhile, FDI from Japan in Q1 2009 posted USD 661 million up 162% year on year. As the country sharply increased investment in the Korean manufacturing industry, especially parts and materials sector, Japan took up 39.4 percent of total FDI, a significant increase from 9.3 percent in Q1 2008. FDI from Japan dropped 53 percent in 2007, yet rebounded 44 percent in 2008. Thanks to the strong yen and depreciation in the Korean real estate market, investment from the Japanese financial sector has risen in H1 2009. Strategic FDI promotion efforts on the back of the high yen-dollar exchange rates and diverse investment incentives resulted in a steep rise in Japanese investment in Korea(82.6 percent).

Investment from the U.S. has been on the decline since 2005, posting a 37 percent drop in 2006 at USD 1.7 billion. Despite the rebound to USD 2.3 billion in 2007(a 37 percent year on year increase), the 2008 financial crisis that hit the U.S. market froze any attempt at foreign investment, leading to a nosedive since Q3 2008. FDI from the U.S. stopped at USD 1.3 billion in 2008, with a 52.3 percent plunge in the services industry.

2.4. FDI by Type

By investment type over the period from 2004 and 2006, FDI through M&A decreased whereas Greenfield investment through establishment of factories or worksites jumped. Greenfield investment, which had been on a steady increase until 2007, fell by 9.4 percent in 2008 compared to the previous year.

M&A investment, which had been on a decline since 2004, jumped 78.2 percent year-on-year to USD 4.43 billion in 2008, accounting for 37.8 percent of the total FDI.

3. FDI Promotion in Korea

Korea's Most Preferred FDI Environments are mitigation of administrative regulations, more tax reduction/exemption, consistency in policy etc. by KCCI survey..Invest KOREA' survey identifies improvements of settlement of sound labor-management relations, internationalization of people's attitude, expansion of market openness, relieving tax burden, expanded use of foreign languages, transparent biz practices, etc.

Table A-5 | Korea's Most Preferred FDI Environment

A 2008 poll of foreign companies in Korea showed the areas which they feel are most important to improving Korea's FDI Environment.

Most Preferred Policy Measuree to Improve FDI Environment (% of responses)	
Mitigation of administrative regulations concerning approval and authorizations	28.4
More tax reduction/exemption	27.3
Consistency in policy	19.5
Improvement in logistics infrastructure	10.4
Stability in labor-management relations	8.9
Supply of land at reasonable prices	3.8
Removal of aentiment against foreign capital	0.9

A survey performed by Invest KOREA identifies what to Improve. *multipe choice N=281(%)	
Settlement of sound labor-management relations	26.7
Internationalization of people's attitude	26.7
Expansion of market opemmess	24.6
Relieving tax burden	19.2
Expanded use of foreign languages	16.7
Transparent business practices	12.8
More liberal financial environment	11.0
Political stability	7.8
Strengthening administrative services	7.8
Improvement in logistics environment	7.5
Strengthening the government's support for R&D	6.0
Others	2.5
No idea/no response	6.0

Source : Kotra, Investing in Korea, 2009

Communication and PR based on fact and reality is most important. The current FDI promotion in Korea as follows.

Table A-6 | Current FDI Promotion in Korea

Solutions

Information is Key: Gathering and providing the proper information will make a big difference	**Devise PR strategy from investor's POV:** The investor is the cutomer	**Communicate with investors:** You must interact with them to know about them	**Hire a professional PR agency:** Expensive, but the investment will pay off in the end
Hire a foreign staff and pay them well: Foreign insight will make a big difference for PR strategies	**Language ability is very important:** Continue to study & hire foreign language capable employees	**Depoliticize FDI:** Attracting FDI is not about personalities. it's about promoting the country	**Avoid exaggerations and be credible:** Make your region a "hup" before you start calling it a "hup"
Benchmark: Identify countries successful at atttracting FDI and go there to see how they do it	**Renk PR activities by priority:** What should money be spent on and what is less important?	**Identify and promote synergy opporunities:** The chance for strategic tie-ups can make a big difference	**Understand and promote your region's strengths:** Not all investment is suite for all regions
Make a long-term PR strategy: Analyze how PR activities will procees in over several years	**Cooperate to devise strategies:** Other regions have more experience; share info and benefit	**Prioritize PR:** What should money be spent on and what is less of a priority?	**Understand the importance of being unique:** FDI will come if there's a niche

Source : Kotra, Investing in Korea, 2009

Table A-7 | Korea's FDI Incentives

Amended in Nov. 2007

Tax Reduction

- Corporate tax, income tax: 100% for 5 yrs, 50% for 2 yrs
- Acquisition tax, registration tax, property tax; 5-15 yrs
- Tariff for capital goods: 3yrs

Cash Grant

- To finance the construction of facilities or the purchase of equipment related to the investment

Location Support

- Reduction or exemption of rent
- Support for building of infrastructure

Others

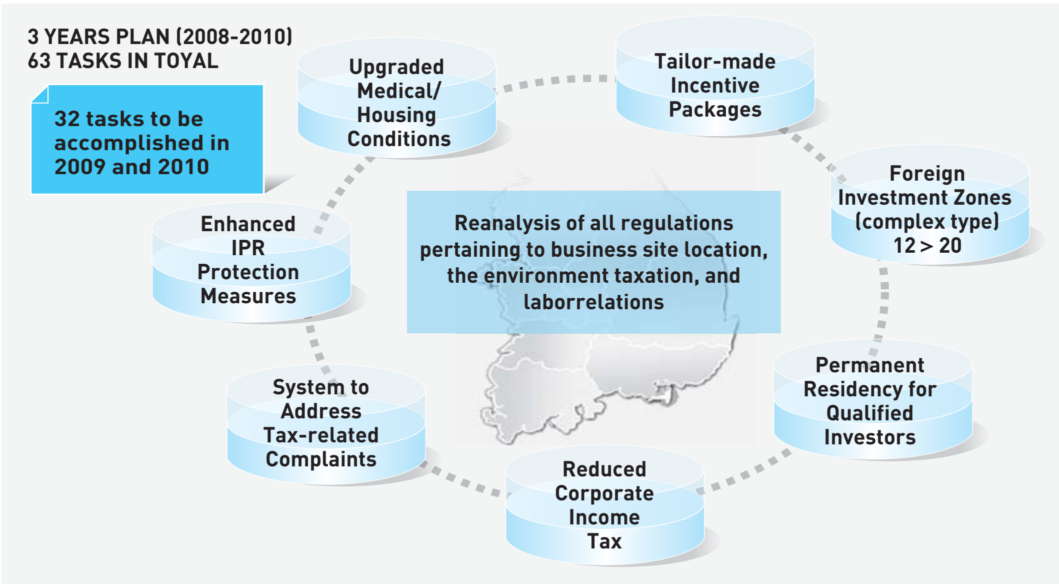
- Subsidies for employment and education
- Support for the improvement of living and management environment

Criteria

- Manufacturing - More than US$30 million FDI
- Logistics & SOC - More than US$10 million FDI
- Tourism Industry - More than US$20 million FDI
- R&D Sector - More than US$2 million FDI

The Korean government formulated 3 years plan(2008~2010) for improving the foreign investment environment and listed 62 tasks in total such as tailor-made packages, increase of foreign investment zones, permanent residency for qualified investors, reduction of corporate income tax, system to address tax-related companies, enhancement of IPR protection measures, upgrade of medical/housing condition.

Figure A-7 | Plan for Improving the Foreign Investment Environment(as of 2009)



Source : Kotra, Korea's National Investment Promotion Agency, 2009

4. Invest KOREA

4.1. Mission and Role

Mission

Invest KOREA(IK), Korea's national investment promotion agency, was established within the Korea Trade-Investment Promotion Agency(KOTRA) with the sole purpose of supporting the entry and successful establishment of foreign business into Korea. With assistance extending to comprehensive post-establishment services, IK enables foreign corporations to maximize the benefits of the Korean investment environment to ensure their rapid settlement in Korea. The agency is committed to providing unmatched, comprehensive one-stop service that allows foreign investors to join many of the world's most successful corporations who have selected Korea as an investment destination and been rewarded by high returns on the investment.

Background

Established in 1998 in the wake of the financial crisis, the Korea Investment Service Center(KISC) was part of a radical liberalization of the Korean investment regime. However, after initial success, slowing inbound capital flows made it apparent that a new paradigm for investment attraction was in order. It was decided this new paradigm would include employing a more proactive approach to induce foreign investors, targeting potential investors with closer reference to the strengths of Korea's industrial base, and developing a one-stop service to accurately address foreign investors' needs and difficulties. It was also deemed crucial for agency staffs to gain a profound knowledge of the industries with which they were dealing.

Launch of Invest KOREA

In addressing the above points, the government finalized a comprehensive plan to attract foreign investment in September 2003 with the twin aims of increasing foreign investment and reforming the overall FDI support system. These changes were embodied in the transformation and expansion of KISC and its relaunch as Invest KOREA.

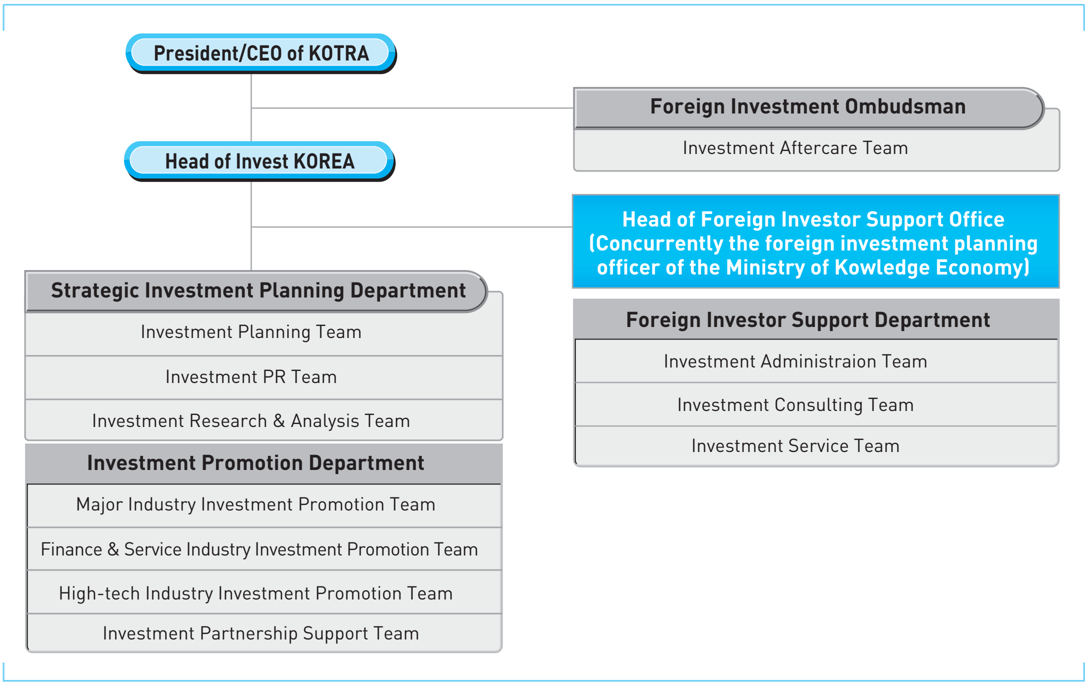
Investment Promotion Systems

Invest KOREA attracts foreign investment by identifying potential foreign investors, supporting investment projects, providing aftercare services for foreign investors, and building a cooperative network with related organizations. IK's investment promotion and support capability was considerably strengthened by the introduction of the Project Manager(PM) system, under which a PM is designated for each investment project to offer customized support throughout its entirety, from providing investment consultation and obtaining licenses and approvals to actually launching a business. In addition to the project managers, as of the end of 2005, Invest KOREA had a pool of 28 experts in such fields as finance, tax, law, securities, accounting, and construction to smooth the foreign investment process and ensure that investors claim the full range of benefits available.

Organization

Based at Invest KOREA Headquarters in Seoul, the Head of Invest KOREA is supported by staff comprised of KOTRA employees, FDI specialists, and government officials seconded from other agencies and ministries. IK works in close consultation with its network of 35 overseas branch offices located in the Korea Business Centers in the major financial and industrial centers of the world. IK implements government policies on foreign investment that have been formulated by the Ministry of Knowledge Economy(MKE) and coordinated by the Foreign Investment Committee, which is chaired by the Minister of Strategy and Finance.

Figure A-8 | Invest KOREA's Organization

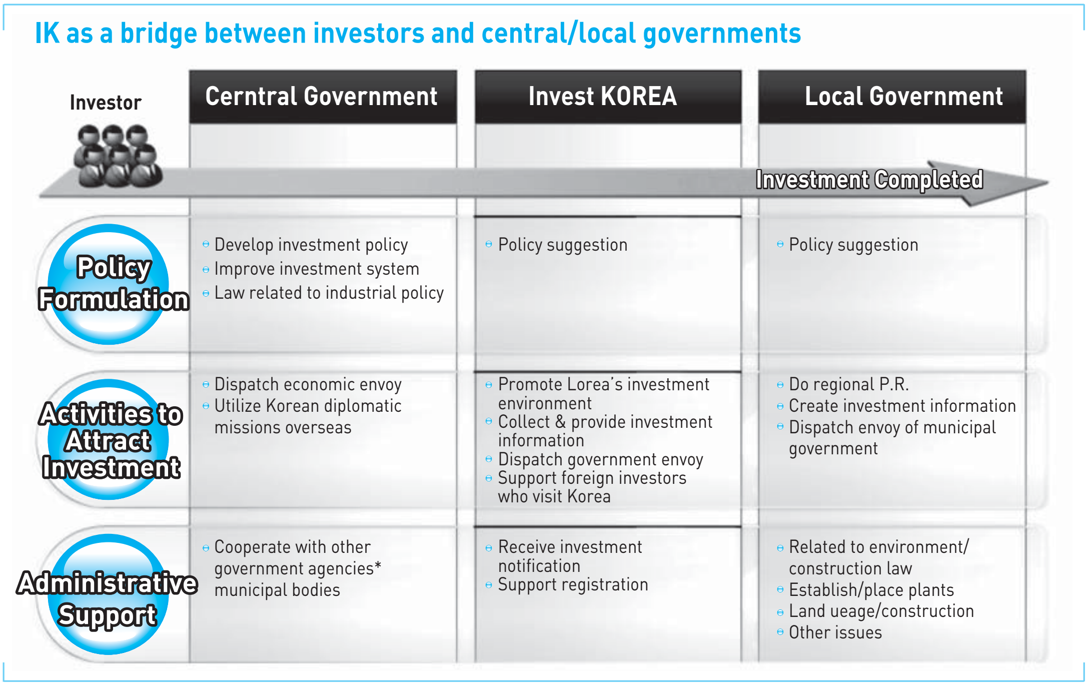


Source : Kotra, Korea's National Investment Promotion Agency, 2009

Figure A-9 | Invest KOREA's Roles of Each Team

Investment Planning	Establish FDI strategy and planning
Investment Public Relations	Promote Korea's investment environment
Investment Research & Analysis	Research & Analyze Korea's investment and external conditions
Main Industry Investment Promotion	Attract and support investment in main industries
Finance & Service Industry Investment Promotion	Attract and support investment in the financial and service industries
High-tech Industry Investment Promotion	Attract and support investment in the hith-tech industries
Investment Partnership Support	Search for overseas potential M&A and joint venture partners for Korean companies
Investment Consulting	Provide consultation on investment
Investment Service	Promore Korea's living environment for foreign investors
Investment Administration	Assist investors with civil affairs: tax, visa, laws, investment notification, customs, etc
+	
Investment Aftercare	Address and resolve investor grievances

Figure A-10 | Invest KOREA's Bridge Role



Source : Kotra, Investing in Korea, 2009

4.2. One-Stop Service

Research/Consulting

Invest KOREA provides information and consulting services free of charge, including the provision of data for feasibility studies and professional advice in the areas of investment procedures, legal issues, tax, and accounting. The agency also helps foreign corporate personnel in matters of day-to-day life such as healthcare, education and accommodation.

Invest KOREA Online

Invest KOREA Online(http://www.investkorea.org) provides a wealth of detailed information on investment in Korea on top of its extensive on-line consulting service for interested investors. We hope you take advantage of the updated information on IK's newly renovated website.

Upgraded One-Stop Service

The range of services offered by Invest KOREA has been significantly enhanced following the opening of the Investor Support Center(ISC) within Invest Korea Plaza.

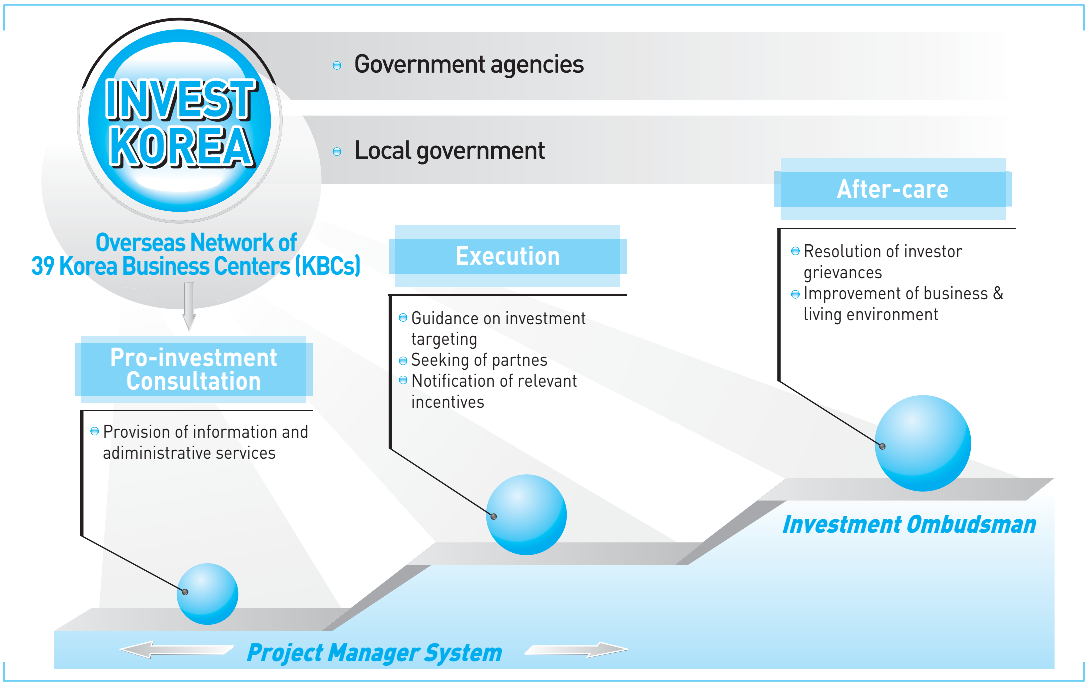
The center provides information and assistance on a variety of matters relating to foreign investment and daily living in Korea, from selecting plant sites and forging alliances with Korean partners, to education and accommodation.

Experts

- Conduct research and provide information about Korea as a business location
- Assist investors to identify emerging investment opportunities
- Answer questions on tax and accounting, and legal issues
- Advise investors on how to take advantage of tax incentives
- Offer free analysis service to investors
- Help investors identify potential joint venture partners
- Offer comprehensive service for the entire investment process
- Including administrative issues
- Handle civil affairs in 11 areas including visa, tariff, and tax
- Coordinate meetings with relevant authorities and official institutions
- Resolve difficulties experienced by investors in the course of doing
- Business through the Investment Ombudsman

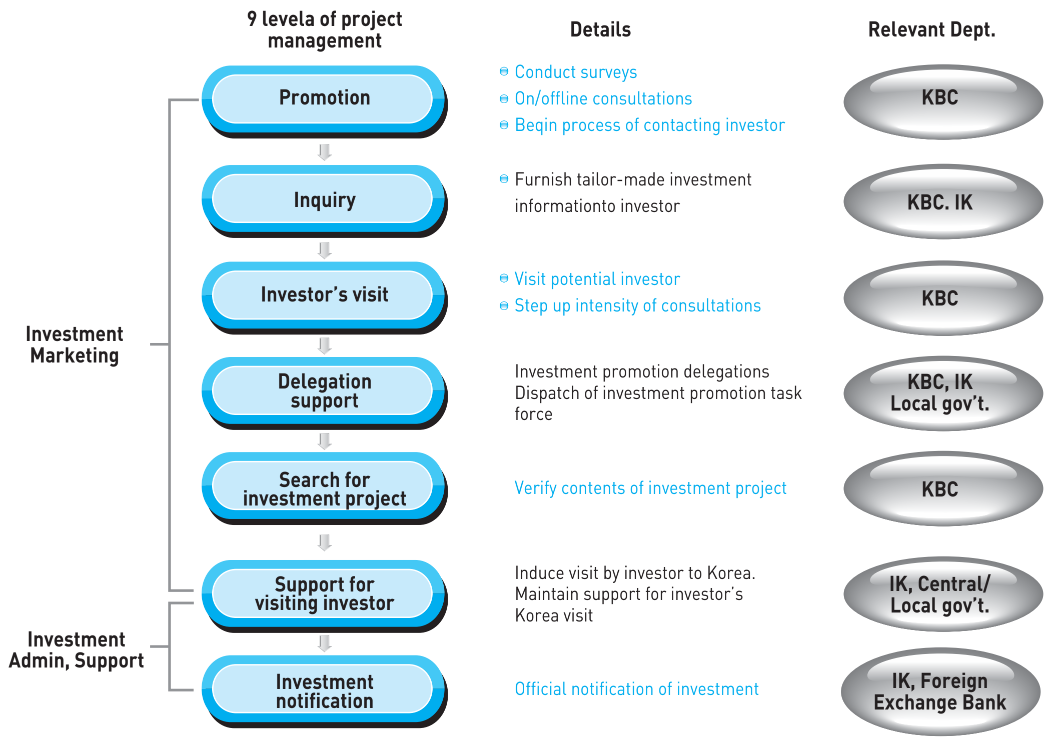
Source : www.investkorea.org

Figure A-11 | Invest KOREA's One-stop Service at a Glance



Source : Kotra, Investing in Korea, 2009

Figure A-12 | Invest KOREA's One-stop Service: Investment Promotion Process



Source : Kotra, Investing in Korea, 2009

Table A-8 | Major Activities(Performance) of IK's One-stop Service(in 2008)

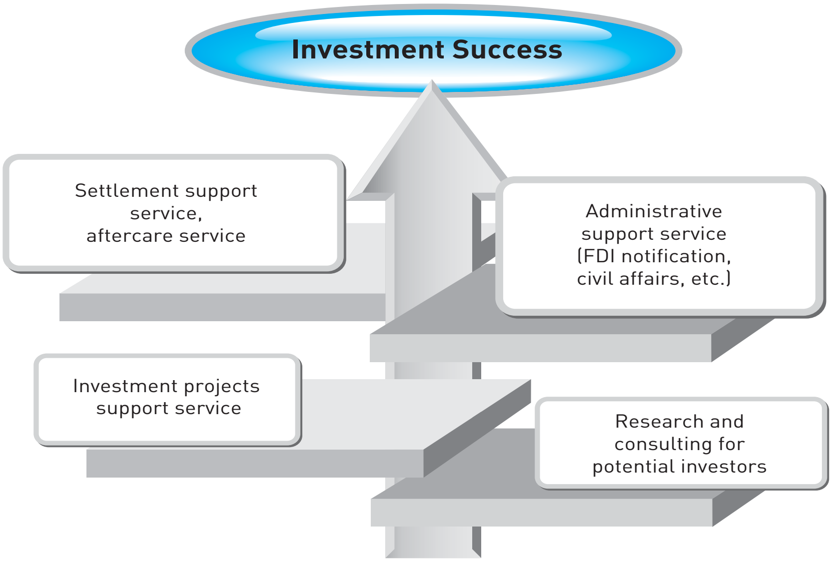
Dealing with civil affairs	FDI notification & registration	Information on gov't policy	Advice on labor-mgt. relations
- 5,633 cases of civil affairs are administered in the areas of ⇨ immigration ⇨ taxes ⇨ customs	- 3,744 cases of FDI notification are processed in 2008 - 1,970 cases of 'foreign invested corp. registration' are processed in 2008	- Liaison between the ministries and IK/investirs - Online consulting via Lnvest KOREA website (www.investkorea.org)	- Labor-Management relations T/F - Moving consulting service to foreign co. thru the year - Labor-mgt. seminars and publications

Source : Kotra, Introduction to One-Stop Service of Invest KOREA, 2009

4.3. Investor Support System

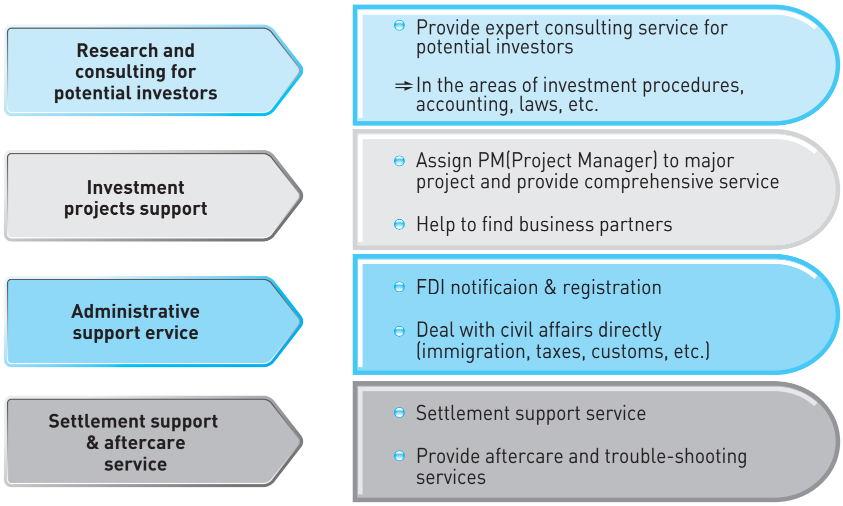
Workflow of Invest KOREA's investor support system is research and consulting of potential investors, investment project support service, administrative support service, settlement support service, aftercare service in due order.

Figure A-13 | Workflow of Invest KOREA's Investor Support System



Source : Kotra, Introduction to One-Stop Service of Invest KOREA, 2009

Figure A-14 | Services Provided at Each Support Stage



Source : Kotra, Introduction to One-Stop Service of Invest KOREA, 2009

4.4. Project Manager(PM) System

IK's investment promotion and support capability was considerably strengthened by the introduction of the Project Manager(PM) system. A PM is designated for each investment project to offer services customized to the client's needs. A PM provides necessary information at every step of the investment, executes administrative services as a proxy, forms and operates task forces to resolve client grievances, and arranges meetings with relevant government agencies, organizations, and investment partners during a client's visit to Korea.

4.5. Aftercare Service and Investment Ombudsman System

The Office of the Investment Ombudsman and the Investment Aftercare Team help foreign-invested companies overcome obstacles in the course of doing business in Korea. As re-investment by existing foreign companies has been on the increase, the importance of aftercare service has subsequently grown. Proactively seeking out potential grievances, the Investment Aftercare Team actively resolves problems on behalf of clients via the "Home Doctor" system. A specialist home doctor is designated to provide one-on-one services for the client until the difficulty in question has been completely resolved.

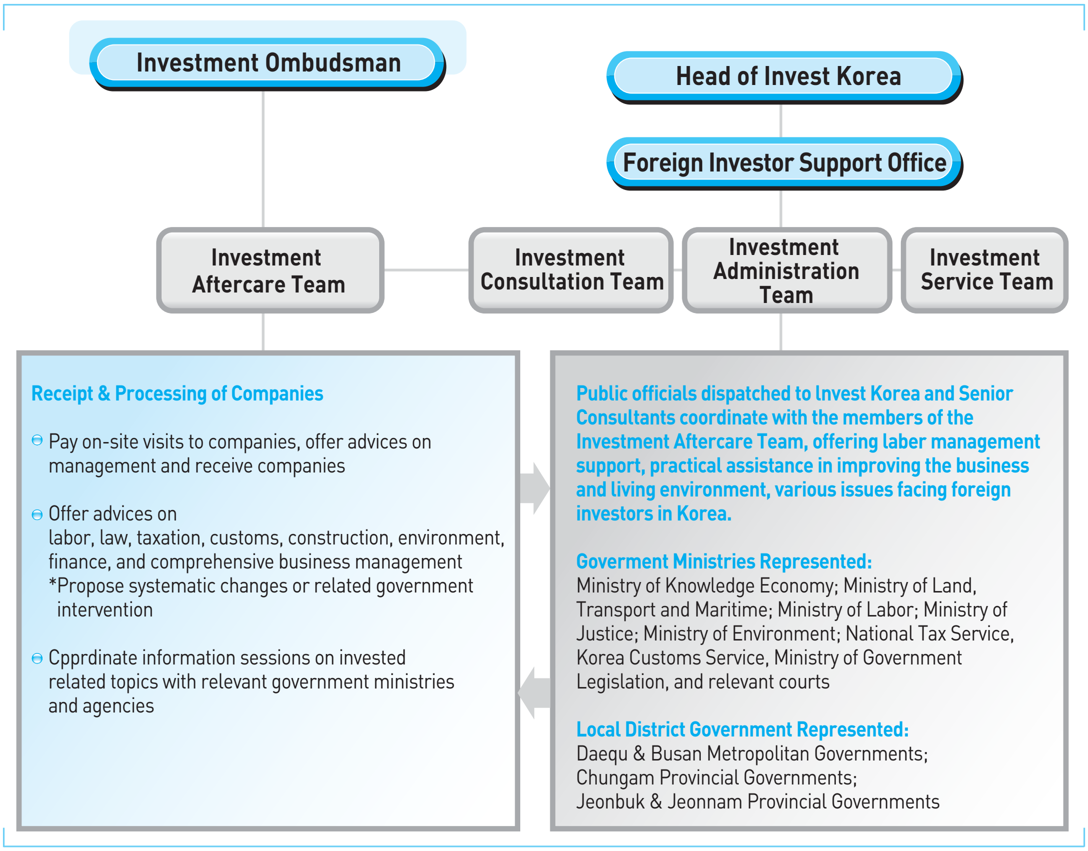
Investment Ombudsman

The Investment Ombudsman was created within KISC in 1999 and has since helped hundreds of foreign-invested companies overcome a myriad of obstacles they have encountered in the course of doing business. Problems that the Ombudsman has helped resolve on behalf of clients vary from obtaining planning permission, removing embargoes and helping investors qualify for benefits, to bringing the full weight of the government to bear in assisting disputing parties to arrive at a satisfactory conclusion.

Investment Aftercare Team

In all cases where the Ombudsman is asked to intervene, a specialist "Home Doctor" is designated to provide one-on-one service to the client until the difficulty in question is resolved. Home Doctors are experts in different fields of foreign investment who act as liaisons, submitting proposals to the government's highest foreign-investment related organ, the Foreign Investment Committee. They report to the Committee on grievances that require changes to foreign investment policy, requesting intervention on the part of relevant government bodies and ministries, and informing them of notable aspects of individual cases for their review. More can be learned about the Ombudsman and the Aftercare Team by browsing at <http://www.i-ombudsman.or.kr>.

Figure A-15 | Invest KOREA's Investment Ombudsman



Source : www.investkorea.org

Figure A-16 | Invest KOREA's Aftercare Process

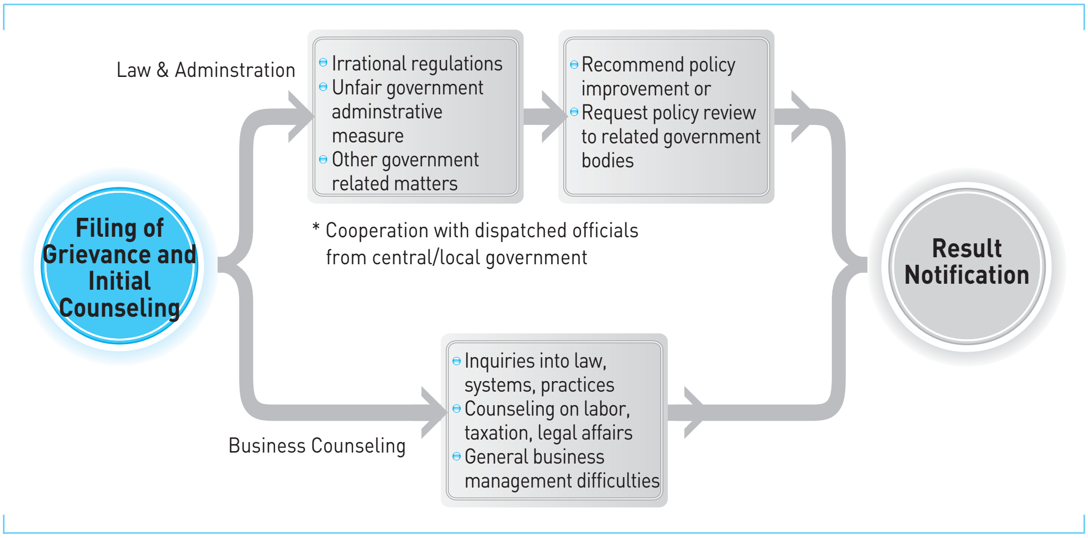
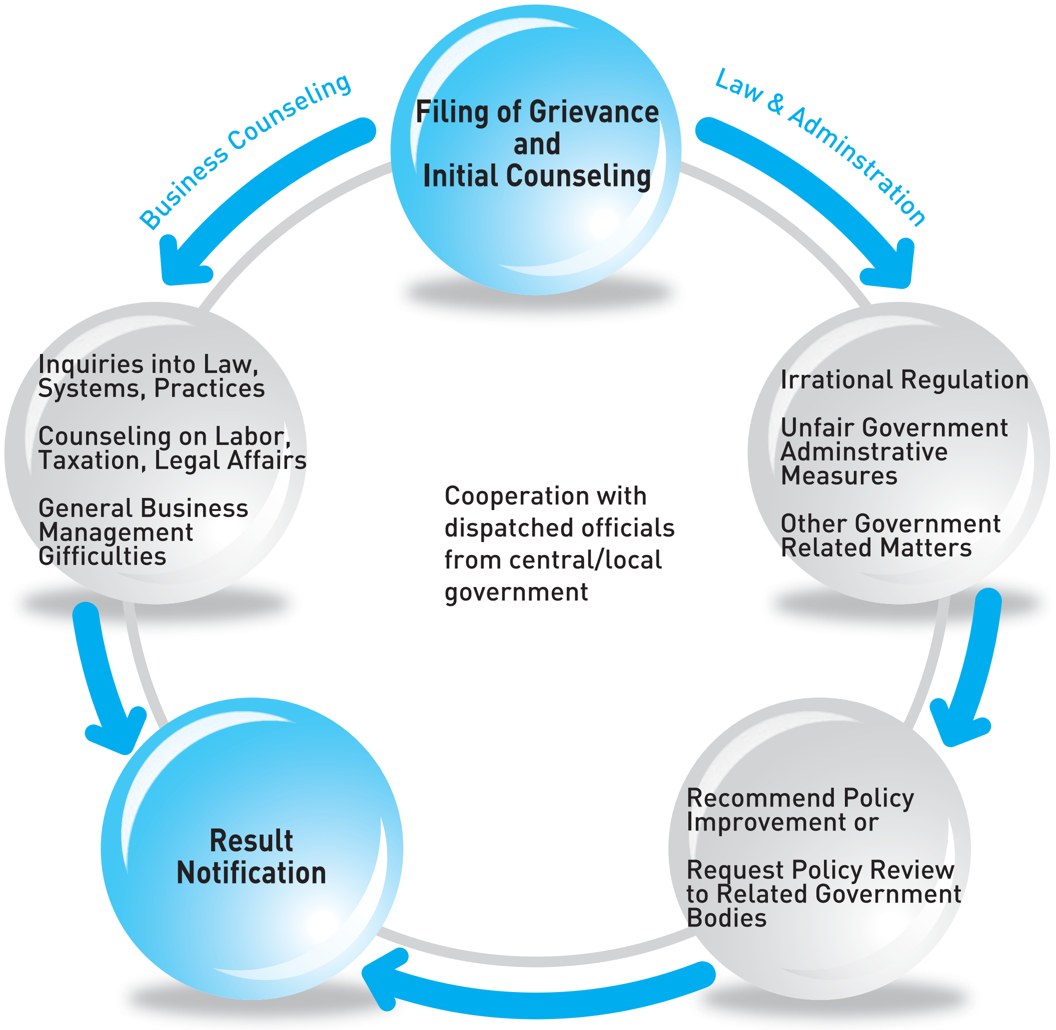


Figure A-17 | Online Grievance Consulting of OIO



Source : www.i-ombudsman.or.kr

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Chapter 03

Operation System and Policies for the Success of Navoi FIEZ

1_ Korean Economy & Special Economic Zones
2_ Masan Free Trade Zone
3_ Proposal for Operation System of Navoi FIEZ
4_ Summary and Policy Suggestions

Chapter 03

Operation System and Policies for the Success of Navoi FIEZ

Hyung-Gon Jeong (Korea Institute for International Economic Policy)

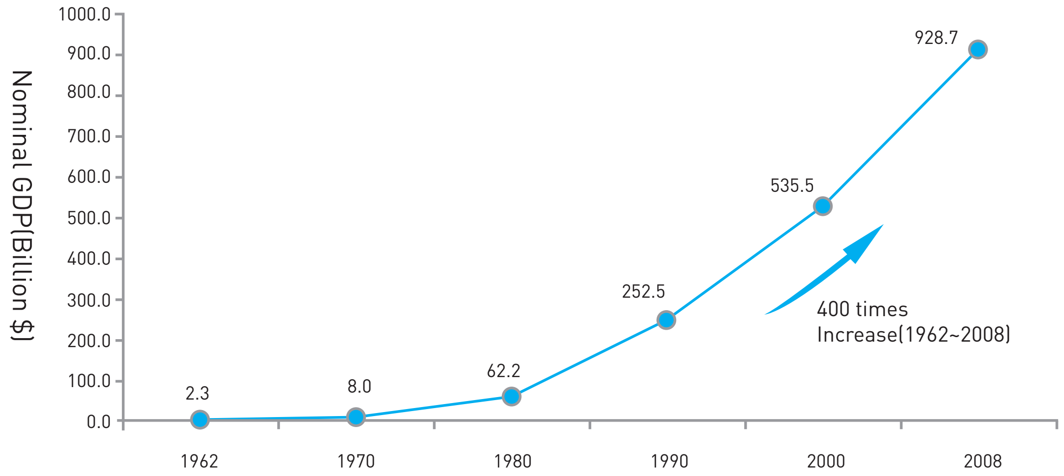
1. Korean Economy & Special Economic Zones

1.1. Development of the Korean economy

After the Korean War in 1953, the country was totally devastated. The Korean economy did not recover from the disastrous Korean War until the end of the 1950s. By the early 1960s, Korea's economic development strategy was characterized predominantly by policies of import substitution with an emphasis on production of consumption goods. But with the establishment of a military government, the policy shifted to export-led industrialization, and as a result, the trade regime was heavily biased in favor of exports during this period. Under the export-led industrialization plan, the government and business fostered a close relationship. The government controlled foreign capital inflows and loan guarantees and offered incentives and disincentives to guide growth. Exports received favorable treatment in terms of exchange rates, foreign currency holdings, import controls and tariff exemptions. Export financing was provided through state-controlled banking system. The business sector responded positively to these government directives.

Korea initiated its long-term economic development plans in 1962 and now it is the 4th largest economy in Asia. From 1962 to 2008, economy has grown rapidly, with the GDP increasing by 224 times and the per capital GDP rising from $87 to $19,504 in 2008. The nominal GDP also grew by 400 times and rose from $2.3 billion to $928.7 billion. Until 1962, most of the Korean population was active in agriculture and the clothing industry, which were labor intensive. With the development of economy and concomitant industrialization, the industrial production shifted from labor intensive industry to high technology industry, which is usually composed of IT & electronics, steel, shipbuilding, auto industry, and chemicals. Tertiary industry accounts for a continuously rising share of Korea's GDP - 55.7 percent in 1970 to 72.4 percent in 2008. The counterpart of this expansion was a fall in the share of primary industry from 26.2 percent to 2.3 percent during this period. The share of secondary industry in GDP was 25.3 percent in 2008. Figures 3-1 and Table 3-1 display the progress made by the Korean economy.

Figure 3-1 | Korea's Nominal GDP



Note : 1995 basis before 1981, 2000 basis from 1981 to 1999, 2005 basis after 1999
Source : National Accounts. The Bank of Korea Economic Statistics System. 16 Feb 2010.
(http://dacos.bok.or.kr/EIndex_en.jsp)

Table 3-1 | GDP by Sector

	1970	2008	Comparison
Primary industry(% of GDP)	26.2	2.3	- 23.9
Secondary industry(% of GDP)	18.1	25.3	+ 7.2
Tertiary industry(% of GDP)	55.7	72.4	+ 16.8

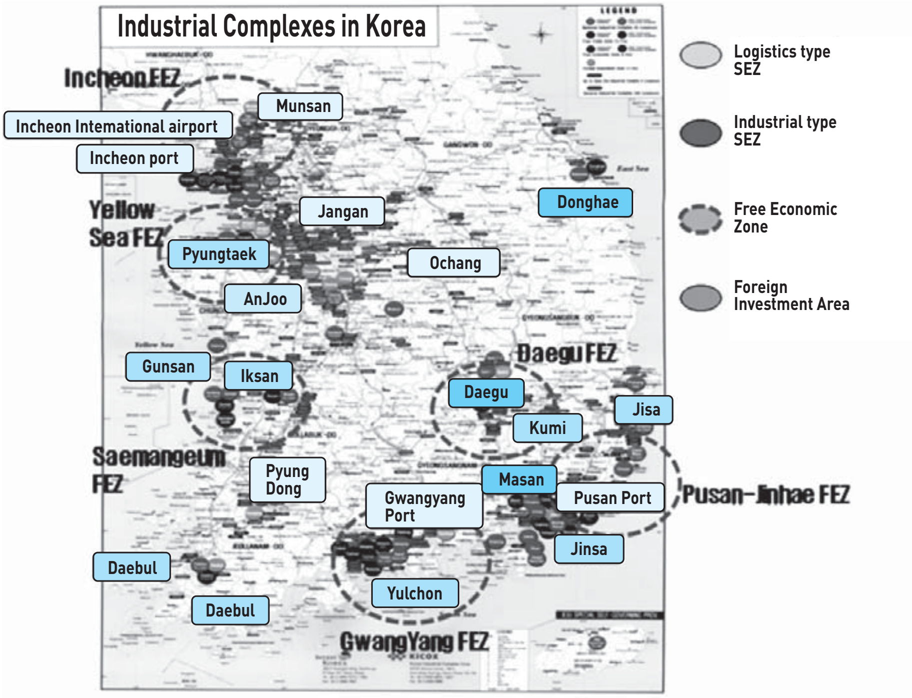
Note : Primary industry includes agricultural sector; Secondary industry includes manufacturing and mining sector s; Tertiary industry is also known as service sector includes a wide range of businesses which involves the provision of services.
Source : National Accounts. The Bank of Korea Economic Statistics System. 16 Feb 2010.
(http://dacos.bok.or.kr/EIndex_en.jsp)

1.2. Types of Special Economic Zones in Korea

The Korean government established Special Economic Zones to promote foreign direct investment, international trade and regional development. A Special Economic Zone (hereafter SEZ) is the most general type of free zone for international trade. A particular area is designated as free from various regulations such as limitations on the number of trades, customs, commodity taxes, foreign currency exchange limitations, and other protection measures for domestic consumers. SEZs in Korea can be broadly divided into two types: SEZ for promotion of FDI and SEZ for balanced development. Free Economic Zones(hereafter FEZ) and Free Trade Zones(hereafter FTZ) in Korea are considered as SEZs for promotion of FDI, while SEZ for regional development, Development-promoting districts, Company Towns, and Tourist Zone are considered SEZs for balanced development.

When organizing SEZs in Korea according to geo-logistical conditions, it is usually classified into five different types: industrial complex, airport & hinterland, logistics complex, freight terminal, and port & hinterland. According to location and operational characteristics, SEZs can be divided into production-oriented and logistics-oriented SEZs. Production-oriented SEZs (traditional SEZ) denote an industrial complex, while logistics-oriented SEZs denote port and hinterlands to be expanded into custom free zones. Figure 3-2 is a map of SEZs in Korea. Red areas stand for production-oriented SEZs, which include Pyungtaek, Gunsan, Iksan, Donghae, Daegu, Masan, Yulchon, and Daebul, while yellow areas represent logistics-oriented SEZs, which include Incheon International airport, Incheon port, Gwangyang port, and Pusan Port area. Designation status is categorized into local areas and it can found in Table 3-2 and Table 3-3.

Figure 3-2 | Map of SEZs in Korea(Sep, 2008)



Source : Invest Korea and Korea Industrial Complex Corp(KICOX). "Industrial Complexes in Korea" [map]. 1:600,000. Seoul: Invest Korea and KICOX, 2008

Table 3-2 | Production-oriented SEZs - Industrial Complex

Division	Masan	Iksan	Gunsan	Daebul	Donghae	Yulchon
Date of Designation	Jan. 1, 1970	Oct. 8, 1973	Oct. 6, 2000	Nov. 21, 2002	Dec. 12, 2005	Dec. 12, 2005
Total Area(1,000m^2) Factory Land	953 638	309 276	1,256 1,008	1,158 911	248 163	343 263
Number of Comparies Registered	83	31	13	26	-	1
Registered Ration(%)	95	100	20.82*	92*	-	-
Export(2006.12) Import(2006. 12)	$3,914,166,000 $2,226,039,000	$159,918,000 $81,957,000	$2,056,000 $514,000	$182,000,000 $13,000,000	- -	- -
Irivestment (Foreign Investement)	$213,329,000 ($134,747,000)	$43,968,000 ($5,313,000)	$156,248,000 ($5,815,000)	$240,300,000 ($1,300,000)		50 (50)
Employment(2006. 12)	7,318	1,501	1,200	3,063	-	20
Major Industries	Manufacture, Logistics, Trade	Same as Left	Same as Left	Same as Left	Same as Left	Same as Left
Rertal fee(1st floor of building) Land	965won/m^2/M 130won/m^2/M (Years 1,560won/m^2) More than 10 million dollars of foreign investment, High-tech More than 10 Years: Free	631won/m^2/M 94won/m^2/M (Years 1,128won/m^2) More than 10 million dollars of foreign investment, High-tech More than 10 Years: Free	652won/m^2/M 80won/m^2/M (Years 960won/m^2) More than 10 million dollars of foreign investment, High-tech More than 10 Years: Free	- 64won/m^2/M (Years 768won/m^2) More than 10 million dollars of foreign investment, High-tech More than 10 Years: Free	-	-
Total Business Capital (100 Million won)	816	-	1,884	1,509	442	482

Source : Jeong, Hyung-Gon. An Analysis of Economic effects of Special Economic Zone in Korea and its Future Prospects. Seoul: KIEP, 2007.

Table 3-3 | Logistics-oriented SEZs - Harbor & Airport Type

Division	Busan port	Gwangyang port	Incheon port	Incheon International port
Date of Designation	Jan. 1, 2002.	Jan. 1, 2002.	Jan. 1, 2003.	Apr. 6, 2005.
Areas(1,000m^2)	5,451	6,755	2,294	2,090
Number of companies registered(Foreign investment companies)	25(22)	15(13)	12(2) *10 existing companies	546(15)
Investment (Foreign investment)	$130,939,000 ($121,439,000)	$321,000,000 ($284,700,000)	Existing Korea companies Moved i(43,849)	$1,08,900,000
Remark (Authority)	The Monister of Maritime Affaires & Fisheries	The Monister of Maritime Affaires & Fisheries	The Monister of Maritime Affaires & Fisheries	The Monister of Construction & Transportation

Source : Jeong, Hyung-Gon. An Analysis of Economic effects of Special Economic Zone in Korea and its Future Prospects. Seoul: KIEP, 2007.

1.3. Masan Free Trade Zone, a Reference Model for Navoi-FIEZ

As we have seen in the previous Table 3-1 and 3-3, Masan FTZ is one of the most productive and representative FTZs in Korea. At the core of its success are inducements by the City of Masan of Foreign Direct Investment(FDI). Masan FTZ is a highly concentrated industrial complex. Although it accounts for only 0.2% of total land area of Korean industrial complexes, it produces 13-15% of overall surplus of the Korean economy. There are 94 companies in the Masan FTZ, and among them, 52 companies were established by FDI. Also, multinational companies, such as SONY, NOKIA, SANYO, have accomplished much and made positive impacts on export and employment. These successful FDIs influenced decisions of foreign companies investing in Korea, and nations with plans for their own SEZs embraced them as good examples.

By virtue of its achievements, Masan FTZ is considered to be one of the best Export Processing Zones(hereafter EPZ) along with the Kaohsiung EPZ in Taiwan. A comparison between Masan FTZ and Kaohsiung EPZ can be found below. When looking at the table below, a great difference emerges between the two. Trade balance of Masan FTZ is three times higher than Taiwan EPZ, although the two zones are similar in size. Also, in spite of having only 50% of the number of employees in the Kaohsiung EPZ, Masan FTZ produces three times the volume of export and import, which denotes higher labor productivity. Success of Masan FTZ is also made apparent by its export amount, where its export amount per m2 is US $4462.42, 9.5 times bigger than the national average of Korea(US $470/ m2). Its success with regard to export amount can be easily recognized in Figure 3-3, which shows amount of annual exports. When looking at year 2008, Masan FTZ shows export amount of US $5 billion, which is a 50-fold growth in 30 years. Also, in 2005, Masan FTZ produced 16% of total export of Gyeongsang-Namdo province and 90% of exports from the city of Masan.

Table 3-4 | Comparison to Kaohsiung EPZ in Taiwan(2006)

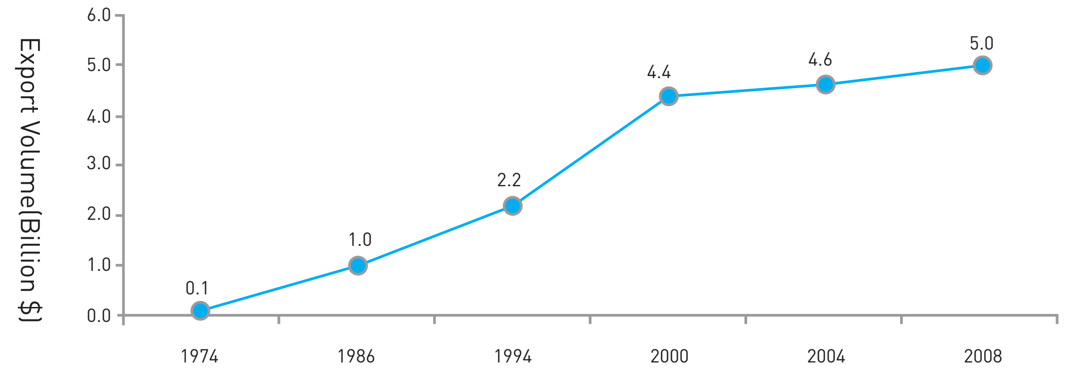
	Area (m2)	No. of company	No. of workers	Import (million $)	Export (million $)	Trade Balance (1000$)
Masan SEZ	793,011	72	8,654	1,455	2,692	1,237
Kaohsiung EPZ	724,003	75	16,293	562	918	356
Comparison (Based on Masan SEZ)	69,008	-3	-7,639	893	1,774	881

Source : Symposium : strategies for success in Ulsan Free Trade Zone. Ulsan: Ulsan Chamber of Commerce & Industry, 2006.

Impacts from the success of FTZs are stronger than what one can usually expect, especially on the economy and trade surplus. First of all, in case of Masan FTZ, its success contributed to stabilization of the local employment situation. In 2005, 75 companies in FTZ hired 8,665 workers, representing 41% of 22,000 total workers in Masan. Also, 57 supporting companies hired 486 workers, and 314 companies near the FTZ hired 5,330 workers. Positive effects of Masan FTZ also contributed to development of the industry. Due to high demands for machinery, materials, and services by companies in Masan FTZ, processing, communication, finance, and logistics industry have developed accordingly. With the success of the FTZ, acquisition of know-how and high technology from foreign companies became possible and became another positive contributing effect on the local economy, because through business with foreign companies in the FTZ, technical skills and technology are transferred to local companies. Success of Masan FTZ had also brought a national trade surplus of US $8.6 billion between 1991 and 2000, which was 65% of the national trade surplus(US $13.3 billion) and contributed to the fast recovery from the IMF economic crisis, recording a surprising US $800 million surplus during the IMF economic crisis.

Due to above-mentioned success of Masan FTZ, operation system and policies of Masan FTZ can be a ready reference model for Navoi FIEZ. Since the Uzbek government is trying to invite Foreign Direct Investment into Navoi FIEZ to strengthen Uzbekistan's export industry, we can derive lessons for Navoi FIEZ from policies related to the Masan FTZ. In the following chapters, policies for export promoting industries in Masan FTZ and operation system for Masan FTZ will be analyzed.

Figure 3-3 | Annual Export Amount in Masan SEZ



Source : Selected Statistics on Masan Free Trade Zone. Masan FTZ Administration. 04 Jan 2010.
(http://www.ftz.go.kr/kor/Morgue/Total/totalYear.jsp)

2. Masan Free Trade Zone

2.1. Objectives

To improve the national and the regional economy, Masan Free Trade Zone was established by the Administration Agency of Masan Free Trade Zone in 1970. According to the Law of Free Trade Zone Establishment(1970), established for purposes of increasing exports, employment, and improving technologies through foreign investment, Masan was designated as an SEZ in 1970. At first, four foreign companies applied for moving into Masan in 1970, and Masan Export Processing zone was renamed Masan Free Trade Zone(MAFTZ) in 2000. In the early stage, the majority of foreign investment was in light industry, but changed gradually to electric, electronics, and precision machinery related industries. Due to strong infrastructure, including an airport, seaport, and highways, related industries, and workforce in adjacent cities, Masan has achieved the highest volume of foreign investment in Korea. As of September 2006, the total investment figure adds up to US $263 million, of which foreign investment amounts to US $183 million(69.4%). Contribution to Korea's trade surplus, acquisition of foreign currencies, and stabilization of local employment are achieved by Masan FTZ. Tariff refund, rent discount, taxation benefit, and simplified customs regulations have been effective in attracting foreign firms. There have been two changes of regulations and revision of the law in 2000 and 2004. The revision in 2000 was drafted to guarantee free business activities through various reforms. Since it was defined an FTZ and a Free Customs Zone separately, the government revised the law in 2004 to integrate trade and logistic functions. As a result of the 2004 revision, Masan FTZ became more attractive to large-scale foreign investment. Although Masan became the standard of foreign investment environment, it still lacks a support system for the existing long-term foreign investment. The Masan FTZ has been successful in creating a linkage between local firms and firms in FTZ. SEZ contributes to the development and the structural upgrading of the national economy as local companies accumulate their technological capabilities by the relationship with firms in the FTZ. Also, the Masan FTZ reflects the long run perspective of a national economic goal, as its export processing zone serves as a catalyst to encourage export as well as to expand investment.

2.2. Operation

2.2.1. Operation system in Masan FTZ

The Masan FTZ is managed and operated by the Ministry of Knowledge Economy. The administrative agency of the Masan FTZ, which is in charge of all administrative services, was created in 1970 under the Ministry of Knowledge Economy. It was established based on the special law to manage the first-ever foreign exclusive industrial complex in Korea, and it was aimed at improving the national and regional economy by attracting foreign investment, driving exports, creating jobs and offering technological advancement. The agency offers speedy administrative services and its work responsibility schedule can be found in Table 3-1. Organization chart of administration agency of Masan FTZ in the early 1970s and present can be also seen in Figure 3-4 and 3-5, respectively.

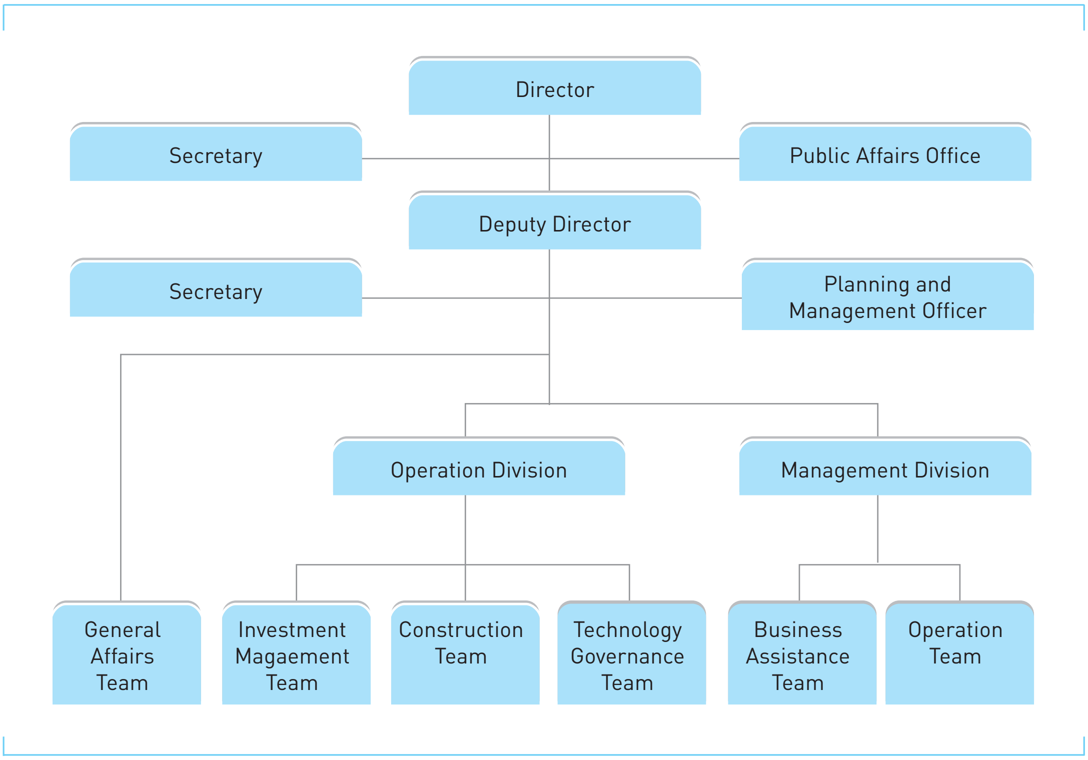
Maturation of FTZ calls for changes in the operations system and numbers of employees. A more complex structure and strong central agency presence can be seen in the operation system of early 1970s in Figure 3-4. Systematic management and operation in early stage of FTZ was necessary. Masan FTZ authority was divided into operations and management divisions. The operations division was in charge of investment management, construction, and technology governance teams while the management division was responsible for business assistance and operation teams. In addition, the general affairs team was under the immediate control of the director. Also, for efficient administration, a secretary and a public affairs officer served as staff for the Director while the Deputy Director had a secretary and a planning and management officer as staff. Early stage of FTZ development required heavy promotion, development and systematic management, which necessitated the placement of a secretary and public affairs officer, and planning and management officer under the direct control of the director and deputy director. However, with the stabilization of FTZ development and less development, in the current system, the role of such positions have been dispersed into lower levels and construction team is no longer placed under the FTZ operation system. With the stabilization of business, in Figure 3-5, current operation system is shown to be a much simplified system. Table 3-6 shows a fixed number of employees by position in 1976 and 2009. All the employees belong to the Ministry of Knowledge Economy and recent trends show dramatic decrease in employees or the members of the Bureau. In 1976, the total number of government officials and employee was 67, while the number went down to 22 in 2009. Decrease in the fixed number of employees provides us with another evidence business becoming stable.

Table 3-5 | Administration Agency of Masan FTZ: Work Responsibility Schedule

Management Team	Export?Team	Emergency Plan Team
• Lease of land and plants, receipt of tax • Issue and maintenance of tenant permits • Collaboration with supporting organizations • Maintenance of facilities of standard factories • Management of documents, Human resources, accounting, etc.	• Attracting, promoting, and registering foreign investment • Permits for export and import, Export promotion. • Issue and maintenance of manufacturing permit? • Tax breaks • Construction permit	• Prepare for national emergency • Security of FTZ

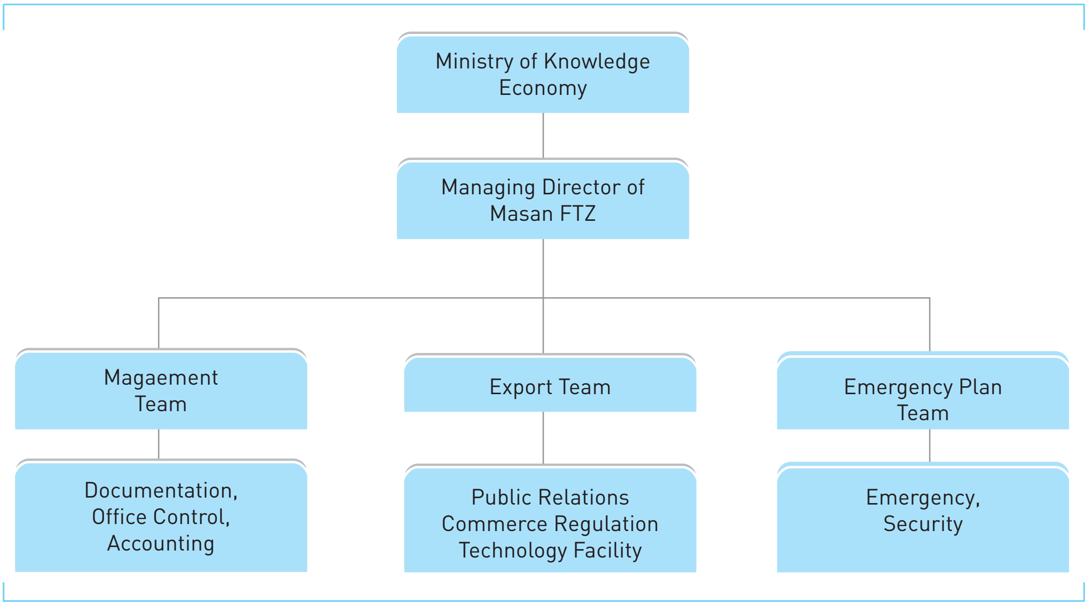
Source : Masan FTZ's 25 years of history. Masan: Administration Agency of Masan FTZ, 1997.

Figure 3-4 | **Operation System of Administration Agency of Masan FTZ(inception, early 70s)**



Source : 25 year- history of the Masan FTZ. Masan: Administration Agency of Masan FTZ, 1997.

Figure 3-5 | **Operation System of Administration Agency of Masan FTZ(present)**



Source : 25 year- history of the Masan FTZ. Masan: Administration Agency of Masan FTZ, 1997.

Table 3-6 | Comparisons between Fixed Numbers of Employees by Position

	2 Gap	3 Gap	3 Eul	4 Gap	4 Eul	5 Gap	employee	total
Fixed no. of employee in 1976	1	4	9	13	13	0	27	67

	4 Gap	5 Gap	6 Gap	7 Gap	employee	Total
Fixed no. of employee in 2009	1	3	6	2	10	22

Note : Gap and Eul represent government officials in Korea
Source : Masan FTZ's 25 years of history. Masan: Administration Agency of Masan FTZ, 1997.

2.2.2. Operating Budget & Revenue Structure of Masan FTZ

Table 3-7 shows the annual revenue budget. Total revenue budget for 1995 was 2.06 billion won. In 1995, rental income constituted 66.7% of total revenue budget and rest or 33.3% are income from public services and miscellaneous income.

Table 3-8 shows the annual expenditure. Total expenditure for 1995 was 2.91 billion won. Maintenance fees for communal facilities and operating expenses show a stable pattern while ordinary expenses show significantly increasing trends since 1990.

Comparison between revenue and expenditure shows a budget deficit because starting from year 1992, expenditures outgrew revenues and as time period gets closer to 1995, there is a trend of rapid increase in the deficit. Expenditure budget was organized within the scope of revenue budget during years 1990 and 1991, when expenditure exceeded the revenue by 18.1% in 1992 and by 41.1% in year 1995. Deficit trend was inevitable, given the fact that the rent was either frozen or slightly increased for securing and supporting competitiveness of newly entering enterprises, while ordinary expenditure increased due to inflation.

Table 3-7 | Annual revenues(by year)

(Unit: 1,000,000 won)

	1990	1991	1992	1993	1994	1995
Rent	1,260	1,328	1,391	1,463	1,047	1,369
Income from public service	857	833	598	598	656	666
Miscellaneous income	20	21	21	28	65	26
Total	2,137	2,182	2,010	2,089	2,368	2,060

Note : income from public service is earning and related expenses from providing services and facilities. When expenditure increases due to the case where demand for public service rises, the government uses revenue to cover the expenditure in order to meet changes in administrative demand and to improve administrative services. ex) Public goods such as sidewalks and electricity
Source : 25 year- history of the Masan FTZ. Masan: Administration Agency of Masan FTZ, 1997.

Most of the operating expense is covered by the rent collected from tenant companies, because there is very little government fiscal support for operating expenses, excluding the labor cost. Labor cost is mostly covered by the government expenditure. Of the labor costs, expense for security guards and security services takes up almost 30% of the total budget. Gas and water utility fees are comparable to what other industrial complexes have been paying and there are no special incentives for companies in FTZ.

Table 3-8 | Annual expenditures(by year)

(Unit: 1,000,000 won)

	1990	1991	1992	1993	1994	1995
Ordinary expenses	765	874	1,010	1,353	1,524	1,683
Maintenance fees for communal facilities	500	555	598	598	656	666
Operating expenses	595	656	766	535	554	558
Total	1,860	2,085	2,374	2,486	2,734	2,907

Source : Masan FTZ's 25 years of history. Masan: Administration Agency of Masan FTZ, 1997.

2.2.3. Banking Service in Masan FTZ

1) General Guidance for Setting up a Bank Branch

There is no special distinctive guideline for setting up a bank branch in FTZ. General guidance is equally applied in FTZ and the following information provides required items for permission, handling time & agency and evaluation criteria. Information also contains cases of relocation and creating new branches of existing financial institutions and foreign financial institutions creating domestic branches. The process of setting up bank branches can be easily understood by looking at the flow diagram in Figure 3-6.

– Application form for permission
- By-laws
- Minutes from inaugural conference
- List of shareholders
- Certificate of Contribution Payment
- Proof of compliance with Banking Law article 15, article 16-2, article 22, and article 26
- Documents certifying implementation of statutes of preliminary permission especially, if the applicant is a foreign finance company, including holding companies, below are the essential documents:

  (Documents certifying legitimacy of the requesting company's representative)

  (Pledge to comply with Korean law, commands and instructions of the Financial Supervisory Authority, mutual agreement between financial institutions, when doing

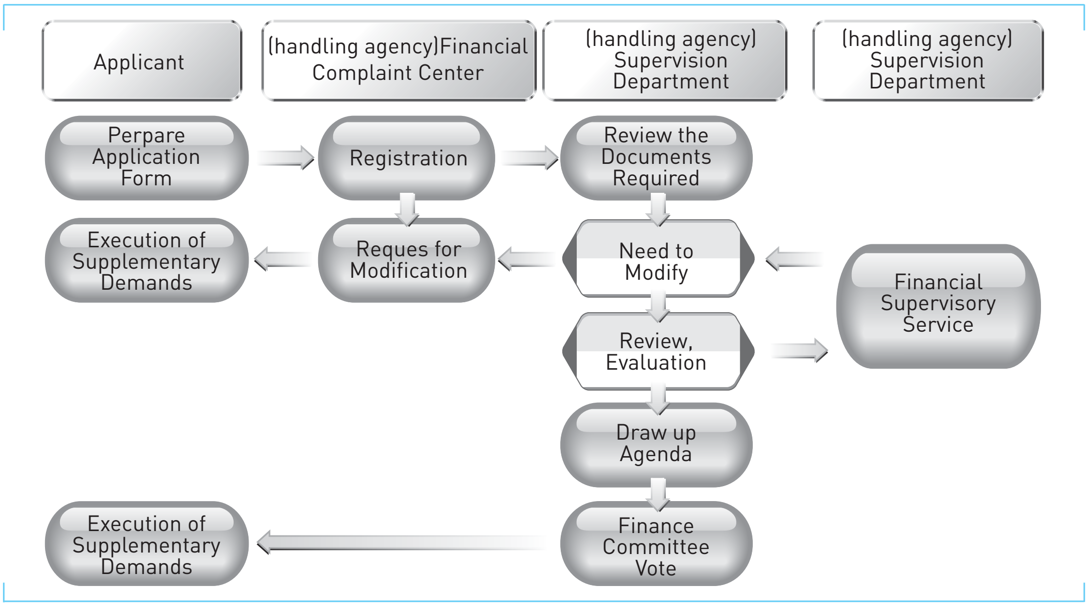
business in Korea)
(Requesting company’ s by-laws)

– Handling time and agency
- Handling time: 30days
- Handling agency : Finance Committee(Bank division)
- Cooperating agencies: Financial Supervisory Service(General Bank Services Department)

– Evaluation criteria
- Validity of capital and shareholder structure
- Minimum capital 100 billion won(if the business area is not nationwide, more than 25 billion won)
- Feasibility of obtaining capital and extra capital
- Plan of shareholder composition should be suitable to article 15 and article 16-2
- Plans for formation of Board of Directors must meet the procedures for such formation stated in article 22 and article 26
- Appropriateness and validity of organizational structure, operating management system, and business plan

– Relocation and creating new branches of existing financial institution
- According to Bank Law article 13, when the financial institution is creating another

Figure 3-6 | Flow Diagram of the Business Process



Source : Approval process of business related issues and setting up financial institution. e-Consumer Service Center. 04 Jan 2010. (http://www.fcsc.kr/)

branch office or business office, or relocating head office to a different place, the company must fill out an establishment plan or a relocation plan and discuss with the finance committee

– Foreign financial institution creating a domestic branch
- In order for a foreign financial institution to provide financial services in Korea, the foreign company must obtain confirmation from the Financial Services Commission. The Financial Services Commission has the right to decide on detailed requirements of authorization, authorization application form, and other necessary requirements.

2) Financial system that promotes export support

① Evaluation Criteria
- Validity of capital and shareholder structure
- Minimum capital 100 billion won(if the business area is not nationwide, more than25billion won)
- Feasibility of obtaining capital and extra capital
- Plan of shareholder composition should be suitable to article 15 and article 16-2
- Plans for formation of Board of Directors must meet the procedures for such formation stated in article 22 and article 26
- Appropriateness and validity of organizational structure, operating management system, and business plan

② Relocation and creating new branches of existing financial institution
- According to Bank Law article 13, when a financial institution is creating another branch office or business office, or relocating head office to a different place, the company must fill out the establishment plan or a relocation plan and discuss with the finance committee

③ Foreign financial institution creating domestic branch
- In order for a foreign financial institution to provide financial services in Korea, the foreign company must obtain confirmation from the Financial Services Commission. The Financial Services Commission has a right to decide on detailed requirements of authorization, authorization application form, and other necessary requirements.

④ Trade bills system
- Exporters issue trade bills based on the export license before shipment. Financial institutions take over the trade bills which allow mediators to sale and offer discounts. Then the payment is used for providing export funding.

⑤ Import financing for export-raw materials
- The export of Korea is highly dependent on import of raw materials. In order to facilitate

the export, the government provides import financing as a part of export promotion policy by relieving the burden for exporters.

- Import of raw materials for purposes of acquisition of foreign currency is different from the case of regular products. According to the article 26 of Foreign Exchange Management Regulations, if a payment guarantee from a bank is available, exporters can open letters of credit without import security deposits.
- Although credit of payment guarantee is not considered the government's direct money supply for exporters, it relieves the financial burden of exporters by granting an exemption of import deposit.
- Through the import financing established from the 28th Monetary Policy Committee in 1967 that stimulates acquisition of foreign currency, the amount of money needed to purchase foreign exchange certificate was funded. By purchasing the foreign exchange certificate, payment to import raw materials could be made.
- Financing for raw material importers. Financing corresponding amount of full price of import price.

⑥ Deferred export promotion regulations

- Deferred export is a type of export that delays the payment for export money for a certain period. Since the large materials such as plants and equipment require high prices, only advance payment is received when export occurs, and the remaining amount is received within 5~7 years.
- There is a great disadvantage for deferred export, in terms of time taken to receive full amount of export payment. In order to alleviate such a disadvantage, the bank provides financing for deferred export so that it can encourage mid-to-long-term export.
- In 1969, the government established a "mid-to-long-term deferred export promotion regulation." It allowed banks to finance manufacturing funding and importing raw materials that will be used for exporting costly goods such as ship and equipments requiring long period of production time.
- The bank provides all the necessary funding until export payment is received, if the economy and politics of partner countries are considered stable, and when credit status of trading companies are considered strong. It is endorsed as a part of heavy chemical industry development policy since the early 1970s.

⑦ Aggregate ceiling trade finance system

- Bank of Korea provides loan for trade finance, because funds from regular financial institutions become insufficient as the trade volume increases
- Aggregate credit ceiling is an loan system that Bank of Korea uses for providing loans/funds to other banks based on loan records such as trade bill discount, trade finance, and small business funding(Such system has been adopted in order to induce regular financial institutions to provide funding to small-medium sized businesses, export oriented businesses, and regional businesses).

3) Financial Support in Masan FTZ

Financial support system in Masan FTZ is identical to that of overall domestic regions. However, there is 'Gyeongsangnamdo Funding for Small and Medium Businesses' as a separate means of financial support system in Masan FTZ. Its support project includes technical development, informatization, business transitions, large enterprise collaboration, inauguration of enterprise, small business development, inauguration management stabilization, and location. Support conditions are facilities funding of 300-600 million, working fund that is less than 300 million, and 2% discount from money market rate. Term of loan for each business is 1 year deferment, 2 year amortization and 3 year deferment, 5 year amortization.

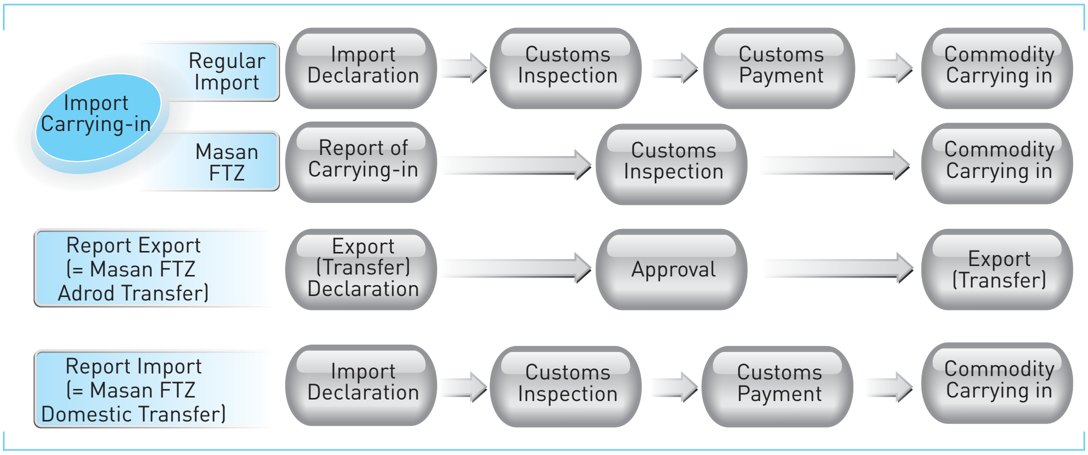
2.2.4. Customs Procedure

In order to attract companies, the government has been providing many customs incentives in following ways: customs waiver, tariff delays, and elimination of refund procedure. When foreign materials and equipments are brought into a Free Trade Zone, no customs duty is owed. However, when transferring foreign goods from customs area(Korea), there will be tariff charges and import declaration and customs formalities procedures are necessary. Generally, no customs duty is imposed to companies in FTZ importing and keeping the items that are subject to general import tariff. Customs duty will be imposed only if imported goods are brought into the domestic market without going through the FTZ. Companies in FTZ are allowed to hold imported goods until the period when they decide to bring the items into the domestic market, from that point, customs formalities procedure will be required and tariff will be imposed. This will facilitate cash flow distribution by granting time control to companies in FTZ. Usually, if re-export is a precondition when importing the foreign goods, tariff should be paid first, and tariff will be refunded when re-export commences. However, in FTZ, there is no need to go through complex refund procedure, because there is no tariff imposed from the beginning. From the money management perspective, this is another significant advantage in that there is no need to hold cash in reserve until refund is received.

Sometimes, imported goods are subject to quota restrictions, but again, such case does not apply to FTZ, because according to the Customs Law, Masan FTZ is considered a foreign region. Thus, Masan FTZ is not subject to the import-export regulation that the Customs Laws controls, such as the import quota system.

Simplified Customs procedure can also be considered incentives in FTZs. In FTZs, a customs declaration is the only thing necessary for incoming-outgoing foreign goods, which precludes the need to go through customs formalities. This will contribute to significant reduction of time and costs, and shorten the inventory cycle as well as timely delivery. Only a customs declaration is needed when bringing domestic goods for the purpose of export, and formal customs procedures are not required. Also, starting in 2009, if repair tools from FTZ are needed for temporary use domestically, a permit will be given under the condition of tariff suspension. Customs procedure will be completed when the tools are returned to the FTZ. Before 2009, after companies in Korea returned the tools to FTZ, they had to go through customs to have their customs duty refunded. Such inconvenience was one of the factors why foreign investors avoided domestic investments. Figure 3-7 is a diagram of customs procedure in the Masan FTZ. In the figure, customs declarations and the approval process are identical. Only differences would be that the inspections for carrying in and transfer are rare(less than 0.1%) and taxation is restrained. Thus, time is saved while going through the same process.

Figure 3-7 | Flow Diagram of Customs Procedure



Source : Customs Clearance. LB 9924. 01 Jan, 2010. The Customs Law. 2010.
Bounded Area. LB 9924. 01 Jan, 2010. The Customs Law. 2010.
Introduction to Import Customs Clearance. Korea Customs Service. 04 Jan 2010.
(http://www.customs.go.kr/kcsweb/user.tdf?a=common.HtmlApp&c=1001&page=/korean/html/kor/entry/import/import_01_01.html&mc=WWW_ENTRY_IMPORT_010)

2.2.5. Cancellation Conditions

There is a cancellation condition for tenant companies. If a tenant company, or move-in, is involved in other type of business different from its core business or its business plan that it used to receive move-in permits and or if company fails to implement the elaborated requirements, the move-in permit will be cancelled. If the company move-in permit has been cancelled by the FTZ, the company must dispose land or plant to the person or company who has the qualification for move-in within 6 months from the cancellation day. If the company is not able to dispose of its property, it must submit a disposal form to the managing rights holder so that the managing rights holder can announce the permit cancellation and select a grantee.

Charge for tax reduction of foreign investment

- If something that is not stated in the tax exemption criteria occurs, upon filing a tax base report for the tax year in which the incident took place, the company must pay income tax or corporate tax including the amount of tax and the interest.

- If the company possesses high technology and plays a critical role in the domestic industry, it will be granted tax exemptions. However, if the company happens to be no longer eligible to meet the criteria for tax exemption, within 5 years, the company will be charged for the reduced amount of tax retroactive from the day when the company was excluded from tax exemption criteria.
- If terms of employment and payment for subject-matter investment are insufficient for tax exemption criteria within the 5 years from the report of foreign investment(tax exemption criteria related to employment is within 3 years), the company will be charged for reduced amount of tax retroactive from the day when the company is excluded from tax exemption criteria.
- Calculation of accrued interest: calculation period of interest accumulation is from the day after the tax base report date of the tax year when the company received a tax relief to the day of tax base report date of tax year when release cause happens.(0.03% of interest rate is applied daily.

2.2.6. Visa and Consular Matters

1) Visa for Business Investor (D-8)

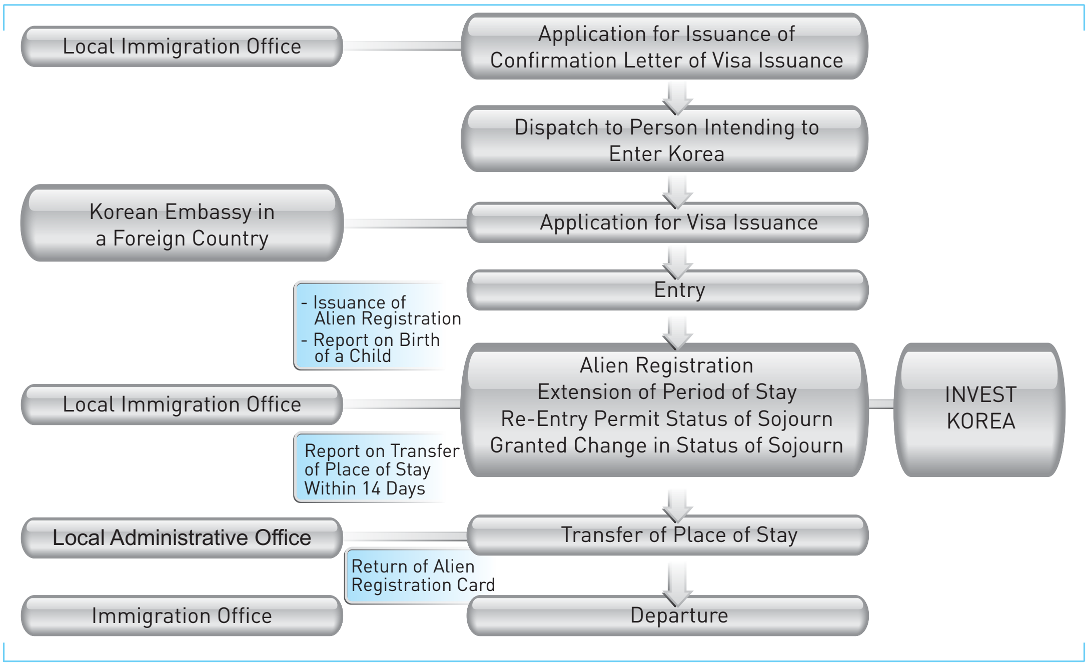
Business investment visa(D-8) is issued for “specialists” engaged in the business management, production or technological sector of an FDI company supported by the Foreigner Investment Promotion Act (not including those recruited in Korea) and "specialists" refers to those stated in the following:

- Executives: Those primarily responsible for the organizational management within a business organization, exercising a wide range of rights in the decision-making process, and only generally supervised and directed by the Board of Directors and shareholders as highest ranking members of the organization(not those directly engaged in the provision of the service).
- Senior Managers: Those responsible for the establishment and execution of the objectives and policies of a company or its organizational units, with authority for planning, control, supervision and recommending, hiring and firing employees; deciding, supervising and controlling the work of other supervisory, professional and managerial employees or exercising discretionary rights over their everyday business (not including those controlling front-line supervisors who are not professional service providers or those directly engaged in the provision of services).
- Specialists: Those with highly professional and proprietary experience and the knowledge essential for the research, design, technology and management of the service provided by a specified business. Those engaged in ordinary administrative services or engineers available in Korea or providers of direct services are not regarded as “essential specialists.”

2) Issuance Procedure for Business Investment Visa (D-8)

An applicant entering into Korea without a visa or with only a short-term visa may apply for a change in the status of sojourn at KOTRA's Invest KOREA (IK) Plaza or at the local immigration office. An applicant may apply for a business investment (D-8) visa at a Korean embassy in a foreign country. Each embassy is authorized to issue a D-8 visa for one year or less by the Justice Minister. Also, an applicant may apply for a business investment (D-8) visa at a Korean embassy in a foreign country with the Confirmation letter of visa issuance or number issued by a local immigration office to an inviting Korean, if the Korean embassy in a foreign country does not have the authority to issue a visa. Figure 3-8 is the flowchart of D-8 visa issuance and sojourn procedure.

Figure 3-8 | Flowchart of D-8 visa Issuance and Sojourn Procedure



Source : Source: Procedure for investor°Øs stay & favorable treatment policies. Invest Korea. 04 Jan 2010. (http://www.investkorea.org/InvestKoreaWar/work/ik/eng/bo/bo_01.jsp?code=102040102)

3) Extending period of stay & Re-entry Permit

D-8, F-3 and F-1 visa holders, who intend to stay in Korea beyond the granted period of sojourn stated in his/her alien registration card, are only eligible for extension of the period of stay. Applicants should apply to a local immigration office or at Invest Korea. Also, applications must be submitted, preferably two months before the expiration of the granted period of sojourn, or earlier if he/she has a legitimate reason, such as an overseas trip. A foreign investor may apply for an extension of the period of stay on an unlimited number of occasions as long as he/she has not been engaged in any illegal activities. An applicant will be granted an extension of the period of stay for up to five(5) years, depending on the size of the business, amount of investment, and business performance.

A registered alien who intends to re-enter Korea within the granted period of stay after a temporary departure is eligible to apply for a re-entry permit. The relevant period is within the expiration date of a passport, the granted period of stay and the granted period for re-entry(one year for a single permit / two years for a multiple permit, but one year for China).

2.3. Factors in the Success of Masan FTZ

There are many factors contributing to the success in Masan FTZ. Factors in the success of Masan FTZ are as follows:

1) Superior Location

The various advantages that Masan FTZ holds include its location, being situated by the harbor with excellent labor resources from surrounding cities, and proximity to related industries and highly-developed infrastructure that encompasses transportation, power, and communication facilities. The Masan FTZ is a seaside industrial complex located on the southeastern tip of Korea, which is strategically located for easy access to large cities and close to Chang-won, Busan, Gwangyang industrial complexes. Such superior location provides easy access to sufficient labor and related services from neighboring industrial complexes (Chang-won industrial complex, which is just 10 minutes away by car from Masan FTZ, is the nation's largest industrial complex with 1,200 companies involved in machinery, metal, electronics, and automobile industry.) Also, the Masan FTZ itself has a strong infrastructure and stands in close proximity to highways, railways and particularly seaports. It is located near ports in Masan and within one hour travel time to the Busan Seaport and Gimhae Airport. (Busan Seaport serves as a gateway to more than 100 nations and 500 seaports around the world, which receives more than 40,000 incoming vessels annually. Also, Gimhae Airport has a capacity of 2.9 million passengers and 140 tons of cargos and provides non-stop air services to China, Japan, Russia, Taiwan, and cities in Korea.

2) Strong Government Support

Korea's central government leads the development and operation of the FTZ and its strong support ensures an advantageous environment for corporate investment by providing inexpensive rent for sites to companies in the SEZ and offering other incentives, such as tax breaks. Although the FTZ does not sell factory sites, the government lends the factory sites at low rent to tenants, which is about 130 won per meter square(about \$0.14/m2). Also, foreign-invested enterprises that invest more than $10 million are exempted 100% of rent for 10 years. Businesses that feature advanced technology and provide industry support service with a new foreign investment of more than US $1 million are eligible to lease factory sites and standard factory buildings. Lease is available for 10 years from the date of entry and it is extensible.

Tenants within the Masan FTZ are allowed to trade imported goods and equipment with one another and to bring raw materials for export into the zone from outside with zero value-added tax. Also, there is another great tax break for foreign-invested enterprises in Masan FTZ, i.e., manufacturing companies that invested more than $10 million and distribution companies that invested more than $5 million are exempt from income and corporate taxes for 5 years beginning in the first taxable year inclusive of the start-up, and 50% reduction for 2 years thereafter. According to the tax exemption law, various tax incentives, such as reduction in land tax, corporate tax, and income tax are equally applied to Free Economic Zones, Foreign Investment Areas, as well as Free Trade Zones. However, companies in Masan FTZ are also exempt from acquisition tax and registration tax for up to 15 years based on provincial regulations.

3) Excellent Timing for Inducement of Foreign Companies

Excellent timing was another factor and it helped in drawing in top multinational companies into Masan. In the early 1970s, the development of the Masan FTZ coincided with the need to move overseas by the Japanese companies as a result of the economic boom. This resulted in the Japanese corporations moving into Masan FTZ. Masan FTZ grew into a complex for concentrated investment by top multinational companies, including Nokia(Finland), Sony (Japan), and Sanyo(Japan). This contributed to the improvement of the FTZ's reputation and helped to increase export and FDI volume. Also, it allowed transferring of its transparent management, profit oriented operation, and active investment in R&D to local companies. Masan FTZ became closely connected to the local business sector through transfer of advanced technologies, shared business methods, high employment and outward processing and contributed to local development.

4) One Stop Service

The government provides one-stop administration services, such as investment consultation, advice, and approval of business, through the FTZ authority. Tenant companies can use the one-stop service in accordance with the Law of Designation and Management of FTZ. In the FTZ, financial institutions and related government agencies, such as the customs office, post office, fire station, and customs clearance have been established to support the businesses.

3. Proposals for Operation System of Navoi FIEZ

3.1. Establishing the Operating System

The governing system for the Navoi FIEZ should be created to offer all services related to the investment in the FIEZ and this organization should be continuously reformed to reflect the new trend and the demand of the market economy. Also, the operation system(administration organization) for the Navoi FIEZ should be efficient and simple, and the role of this organization should be clearly assigned. The Navoi FIEZ should be managed by a central government agency. The FIEZ committee(the consultation organization) and the FIEZ planning office(the administrative organization), are the two central governing entities. The governmental support, deregulation, and related administration procedures should be handled by these two organizations. In addition, for a fair and immediate resolution of a conflict, the grievance mediation center should be established to straighten the international trade order.

The governing entities in Navoi FIEZ should reform themselves continuously in line with the pace of evolution of the market economy. In the early stage of the establishment of the FIEZ, the administration organization can be too large or inefficiently organized. But the organization should continuously reform itself to eliminate inefficiency, and strive to increase its competitiveness as an economic management system. One of the major goals of the operation of Shenzhen SEZ in China was to reform government organizations and agencies to reflect the new trend of free trade and a mature market economy. Thus, the administration organization had been reformed five times between 1982 and 1992. The organization was simplified and complemented for more efficient operation. The structure of the administration organization was rearranged, and each administration agency was assigned a distinctive role. This reform process of the administration organization of Shenzhen SEZ can be applied to Uzbekistan. Like China in the 1980s, Uzbekistan has yet to convert fully to the market economy. The administration organizations in Navoi FIEZ should be adjusted to fit the market economy.

1) Consultation Organization and Administrative Organization

To provide efficient and integrated support for investors and to support economic activities, integration of functions under the goal of supporting investment is required. The FIEZ committee and the FIEZ planning office should be independent from other related government agencies, and be able to initiate the selection and expansion of the Navoi FIEZ by providing directions and detailed strategies.

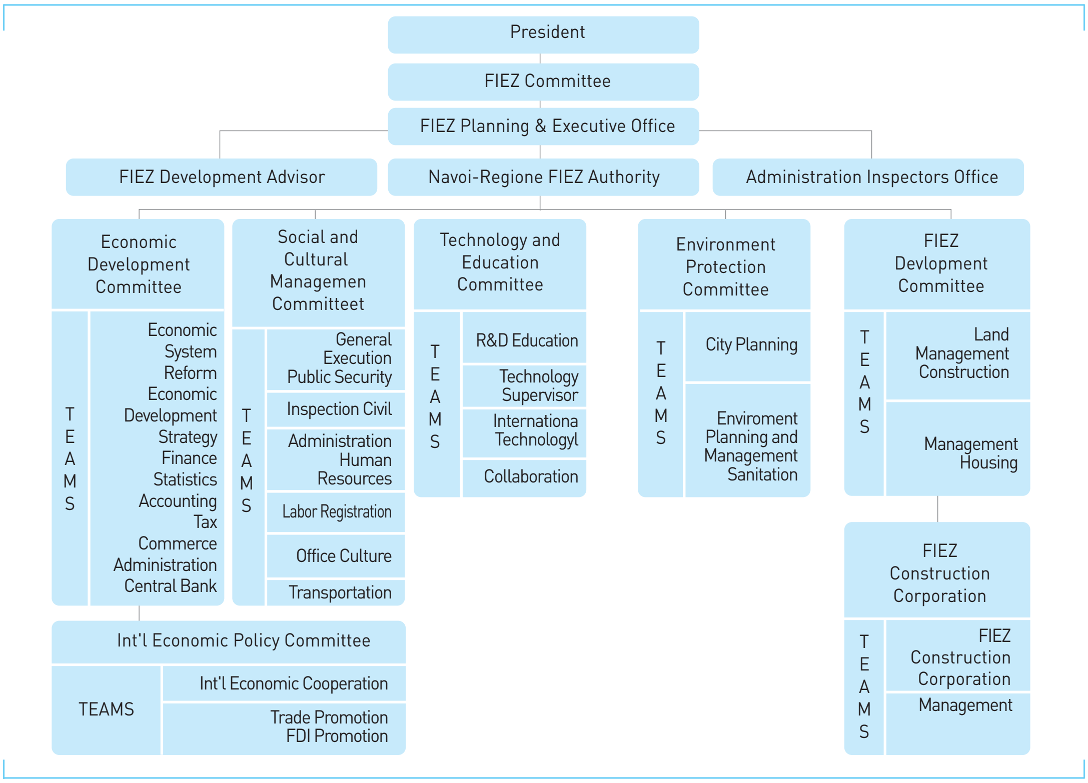
① Role and Organization of the FIEZ Committee

The FIEZ committee is the consultation organization that establishes general development plans for the Navoi FIEZ and supervises its development. To eliminate redundancy in administrative procedures and to operate efficiently, the role of the FIEZ committee should include selection of target industries, planning of long-term projects, formulating the annual development plan, and managing the FDI promotion activities.

The FIEZ committee makes general decisions about the establishment and the operation of the Navoi FIEZ. The committee should be organized to reflect government initiatives and the demands of the field. It would not be advisable to include only government officials in the committee. Professionals of economic and financial circles including CEOs of foreign companies and members of the chamber of commerce should participate in the committee. For example, non-government participants represent two-thirds of positions in the Industrial Development Agency(IDA) of Ireland. Economic Development Board(EDB) of Singapore also invites CEOs of foreign companies and representatives from labor organizations to participate. This way, decisions of EDB reflect the needs and demands of the field.

An advisory committee composed of professionals from outside can be utilized to suggest objective opinions about the Navoi FIEZ operation. EDB of Singapore is working with an advisory committee, an independent organization that collects ideas and proposes international and regional development strategies to the EDB. This committee helps connect Singapore to the

Figure 3-9 | Operation System of Navoi-FIEZ(Proposal)



international enterprise unions by suggesting effective economic strategies. IDA of Ireland also utilizes various advisory committees. The Science Council is a high-level government advisory committee that discusses issues on science, technology, and innovation. This committee also creates important interactions between interest parties of each areas of study and the policymakers, and develops and diffuses strategies for innovation strategies in science and technology. The Expert Group on Future Skills Needs(EGFSN) is an advisory government organization that proposes necessary education and training programs to satisfy the future demand of technology for industries of Ireland. The National Competitiveness Council(NCC) is a governmental advisory organization created to discuss and report on key issues about competitiveness of Ireland's economy.

In order to prevent possible corruption in the absence of the legal regulations in the early stage of the Navoi-FIEZ establishment and to enforce responsible administration, it is advisable to create the Administration Inspector Office that supervises the general administration in the FIEZ. After the FIEZ establishment, the inspector's office should be maintained to maximize efficiency of FIEZ operation and prevent corruption. A continuous audit and administration inspection should be conducted to inspect government officials from abusing their authority and conspiring with companies. Also, the administrative system should be constantly supervised to see if it is operating in accordance with the reformed system.

② FIEZ Planning Office

The FIEZ planning office is an executive body that enforces decisions of the FIEZ committee. In order to achieve success of the FIEZ, the FIEZ planning office should prepare a long-term development plan, manage regional FDI activities and regional development, reform the management system, and ease regulations. Also, it should manage the governmental support for FIEZ projects and mediate FDI activities of Navoi FIEZ. To promote FDI, it should focus on creating national-level development strategies that go beyond the regional level. National-level strategies include building a business model, creating investment attraction strategies, and developing financial services.

It is important to create long-term strategies so that the FIEZ can become the foundation of future economic growth of Uzbekistan. In the early stage of the establishment of the Navoi FIEZ, due to rapidly increasing amount of work, the FIEZ operation may be busy resolving pending questions and concentrate on immediate matters of management. To pursue the long-term plan of the FIEZ on a continuous basis, the structure of the FIEZ planning office should be flexible enough to expand the organization as the amount of work increases. Also, early operations may create unexpected situations due to lack of experience, therefore, by keeping the organization flexible, the planning office should be prepared to cope with different and diverse situations. Because the FIEZ planning office manages operations of several government organizations, it is important to create an active communication network. This can be done by forming a cooperative organizational culture.

③ Cooperation of the FIEZ Committee and the Planning Office

The consultation organization and the executive body can be integrated into one organization or they can operate separately. In case of Ireland and Singapore, one organization performs two functions. One way or the other, it is important to create a communication path between the two functions. The cooperation system should be created, so the planning office can express its needs and demands to the committee and the consultation can reflect the request of the planning office.

2) Navoi FIEZ Authority

Navoi FIEZ Authority is in charge of the actual administration in the Navoi FIEZ region. The organization should be guaranteed autonomy, a special status, and responsibility. Also, its tasks should be spelled out clearly, not only between the government and the Navoi FIEZ authority, but also between the regional Navoi administration and the Navoi FIEZ authority. When the tasks are divided, it should reflect the focus and the purpose of each organization.

In order to guarantee independence and autonomy of the Navoi FIEZ authority, it should have discretionary power over employment, organization and budget. With its discretionary power, the Navoi FIEZ authority can be ensured of its independence in operation, that is, it can offer an aggressive reward system to employees so the Navoi FIEZ projects can be completed faster and more efficiently.

If there is an administration service of the Navoi FIEZ authority that is also being offered at regional administration and the FIEZ planning office, the Navoi FIEZ authority should unify the service and take over responsibility. Most importantly, to attract foreign capital, the Navoi FIEZ authority should offer one-stop-service for all the administrative procedure.

① Lower Branches(supporting organizations) of the Navoi FIEZ Authority

For the efficient operation of the FIEZ, supporting branches of the Navoi FIEZauthority must be strong. First, the FIEZ should have an Economic Development Committee. This organization is in charge of general economic affairs. Local banks with foreign capital participations should have their branches in the FIEZ to secure free currency exchange and money transfer. The Economic System Reform team resolves conflicts between the initial development plan and market economic factors by providing intensive researches. And it finds a long-term growth model for the FIEZ by improving investment environment.

The International Economic Policy committee is in charge of international trading in the FIEZ. It analyzes possible problems for investors and obstacles in investment, and it reports to the Navoi FIEZ authority and the FIEZ committee about the issue. The FDI Promotion team is in charge of the registration and approval process for foreign companies, branches, or offices built by foreign investors.

The Social and Cultural Management Committee manages public security and immigration control. It issues and manages various certificates about immigration, visits, and residence, and it also issues and manages the export and import of automobiles and equipments. Also, it takes care of social problems and crimes related to immigration.

The Technology and Education Committee would be established to facilitate the transfer of technology from foreign companies and to train skilled labor. Other than acquiring know-how on corporate management and market development, one of the biggest benefits of the FIEZ establishment is the transfer of foreign high-technology. Corporations in the FIEZ and Uzbek companies should maintain close relations for successful technology transfer. Usually, foreign technology is transferred from foreign companies in the FIEZ to subcontractors in Uzbekistan, and this interaction contributes to the technological advances in Uzbekistan. If subcontractors of Uzbekistan cannot satisfy the demands of foreign companies, foreign companies will acquire the materials directly from abroad rather than from Uzbek subcontractors. In the early stage of FIEZ establishment, the level of skilled labor may not satisfy the standards of foreign companies, and at the same time, preferential tax would be applied to material imports due to aggressive FDI promotion policy, thus, foreign companies would choose to simply import the material. If this situation continues, technology transfers may not reach the level that Uzbekistan initially intended. Therefore, training and educating programs are critical in improving skilled labor to levels that satisfy the demand of foreign companies. The success of the FIEZ is only possible when the level of technology and skilled labor in the FIEZ satisfy the expectations of companies in the FIEZ. To maximize the effect of technology transfer, it is advisable to build a high-level educational institute in the FIEZ and absorb qualified individuals from the entire country. This way, engineers and scientists educated in the FIEZ can contribute to the economic growth of Uzbekistan.

The Environment Protection Committee manages general environmental issues in the FIEZ. One of the negative side effects of establishing the FIEZ is environmental contamination, for example, polluter industries produce negative externality and should not be concentrated in the FIEZ. To reduce the risk of environmental contamination, the committee should promote usage of environment-friendly technologies.

The FIEZ Development Committee manages the development of infrastructure and construction of the industrial complex. The committee is in charge of the registration and approval procedures for all construction works and administration services for the general management of the land and buildings, including their rent, mortgage, and cession. Also, the committee creates and manages basic infrastructures like electricity, gas, industrial water, and communication systems. In principle, development of the infrastructure in the FIEZ should be funded by the government, but in cases of financial deficits, foreign contractors may take charge of the construction. In case of Shenzhen FIEZ of China, several policies were created to acquire finances from Hong Kong to fund construction of infrastructures including power plants, highway, and port.

When the FIEZ construction is delegated to a foreign contractor, the contractor is assigned to be the FIEZ Construction Corporation and managed. In this case, Uzbekistan should guarantee the privileges for using the land to the FIEZ Construction Corporation. The authority for distribution should also be granted to the corporation for timely retrieval of invested capital and the distribution process should be managed directly by the corporation. The Navoi FIEZ Authority should support the corporation by providing administration services and clarifying the authority and responsibilities of the corporation, preferably granting rights for independent operation.

② Cooperation of the FIEZ Committee and the Navoi FIEZ Authority

The Navoi FIEZ authority should be granted autonomy, but it cannot be managed outside of the governmental control. The FIEZ committee, the Navoi FIEZ authorities, and non-government advisors can form a cooperation committee to facilitate systematic cooperation between the government and the region. When establishing a development and operation plan for Navoi FIEZ authority, the direction of the government support and policies should be fully reflected. It is advisable to involve the head of the FIEZ committee in the cooperation committee to lead the FIEZ operation in accordance with the policies of the government.

3.2. Alleviating Regulations

1) Enactment of Laws to Increase FDI

The investment legislation of Uzbekistan is one of the most advanced among CIS countries, incorporating major provisions of international investment laws, in particular, regulations on guarantees of the rights of foreign investors, certain preferences for investors and others. Uzbekistan has created a favorable investment environment by establishing laws based on protection of foreign investment and rights of investors, especially in the security market.

The legal foundation for FDI has already been established, but Uzbekistan's<Laws Concerning the FIEZ> enacted in April, 1996 has been rendered virtually ineffective. This law is in critical need of redefining to successfully establish and operate the FIEZ. The law should distinctively clarify the administration processes in FIEZ construction, characteristics of the FIEZ, and the possible range of industries and business activities permitted in the FIEZ. More importantly, <Laws Concerning the FIEZ> should be a special law, so the FIEZ can be given preferential regulatory treatment, outside the control of regular Uzbek law. Details about the law, including the FIEZ selection process, incentive policies, business regulations, and the FIEZ development agencies and development fund, should be defined precisely and accurately. Also, existing laws about FDI and foreign companies should be unified and readjusted to conform to <Laws Concerning the FIEZ>

2) Alleviating Regulations

All administrative procedures necessary for appointing and developing the FIEZ should be stipulated clearly. The tax and funding system, tax preferences, and social cost exemptions should be prescribed. Companies in the FIEZ should be exempted from domestic regulations about labor, environment, and transportation.

When easing regulations, every regulation applied to the FIEZ should be reformed decisively. The FIEZ operation should be independent from domestic laws. Especially, laws about environmental protection, construction restrictions, the labor market, the business environment, and living conditions should be redefined to favor foreign investors. Inefficient administration procedures, including deliberation and consultation stages, should be minimized or eliminated.

3) Regulation on Environmental Protection

Importance of environmental issues has been brought to the attention of the international community, and an assessment of environmental impact is now required for development or facility installments over a certain scale. If the FIEZ development plan is applicable to the assessment of environmental impact, the criteria should be expressed explicitly so that the assessment can be efficient.

Foreign companies in Uzbekistan that comply with the Clean Development Mechanism of the Kyoto Protocol can benefit from the tax preferences on their profits in Uzbekistan. Governmental promotion of the international environmental standards to companies in Uzbekistan is important.

3.3. Improving the Investment Environment

The economic system of Uzbekistan has not fully adjusted to the market system, for Uzbekistan has recently undergone transformation from socialism to capitalism. In order to attract FDI and operate the FIEZ successfully, it is critical to sustain a stable market system in the FIEZ. This way, the collision of ideologies between foreigners and people of Uzbekistan can be minimized, and foreign companies can run their business successfully. Furthermore, to create a competitive FIEZ, a friendly business environment should be established, that is, the Navoi-FIEZ should offer various incentives and a transparent administration system which is free of corruptions.

1) Stable Investment Environment

The most important criteria of a ‘good’ investment environment are profitability and likelihood of retrieving the invested capital. It is based on these criteria that investors decide whether to invest or not. Therefore, guaranteeing property rights of investors' capital is the most important legal prerequisite.

First, transferring profits aside from taxes to outside of the country should also be guaranteed. In case of bankruptcy of a foreign company or a joint venture of a foreign company and a domestic company, losses should be apportioned fairly, and remittance of residual assets should be guaranteed. Foreign currency should be freely convertible, and various methods of payment should be prepared in accordance with the preference of foreign companies. If there is a currency conversion obligation of the profit for a foreign company created with a foreign currency, the obligation should be revised or eliminated.

All contracts with foreign companies should be legally enforced, and methods of mediation to resolve legal conflicts between foreign companies and business partners of Uzbekistan should be prepared. Furthermore, contents of contract should be protected against unfavorable interpretation to foreign investors. Guaranteeing these conditions is critical to reducing risks of investing in Uzbekistan.

2) Tax Preference and Incentives

To create a flexible and adaptable tax system, the target industries liable to tax preference and the terms and condition of the tax preference should be set to attract FDI of diverse investment types and the scales. As famous multinational corporations are especially difficult to attract, additional strategic incentive system should be prepared and applied to these corporations. Degree of the preference to foreign companies should be determined flexibly within the scope of the law with consideration of ripple effects on the Uzbek economy and the tax preference systems of rival countries. Also, it is advisable to rearrange the tax systems of other FDI promotion areas of Uzbekistan to conform to that of the FIEZ.

3) Improving the Living Conditions

In order to help foreign investors settle down and concentrate on business activities, it is important to create suitable living conditions. Convenient transportation system and guaranteed security form the most basic conditions. Housing, schools, and medical institutes should be built to facilitate settlement. Housing plan should also be one of the priorities. The supply of housing for foreign entrepreneurs should be increased, and the methods to supply housing should be diversified. According to a survey of foreigners in Korea, foreigners prefer apartments(51%) over individual houses(10%), and rental houses(72%) than own houses(14%). To ensure a stable supply of housing to foreign entrepreneurs, legal basis for supplying rental houses should be prepared, and urban environment should be improved to create comfortable living conditions.

In addition, reasonable incentives should be offered to attract foreign educational institutions. In addition to incentives, the cooperation of government agencies, the living conditions, and the level of internationalization also determine the entrance of such institutes, therefore, regulations related to educational institutions should be eased while the living conditions improve. But before modifying the regulations, a survey should be conducted to test whether the demand of students for foreign educational institutes is sufficient. A long-term plan for the educational system should be prepared so that the education system can facilitate economic growth, secure domestic and foreign talent for industrial activities, and eventually create more jobs. Singapore created the Education Ecosystem, and in 1998, MIT and Johns Hopkins University of United States built their branches in Singapore. Also, INSEAD of France, the University of Chicago, Stanford, Duke, and Wharton business school created branches and joint-degree programs with universities in Singapore. To attract foreign universities, the FIEZ committee should be involved directly and again offer one-stop administrative service. In case of institutions that are exclusive to foreigners, an assessment of demand is essential, as they may experience troubles in management until the number of foreigners sufficiently increases.

4) Attracting Foreign Research Institutes

Research institutes are non-profit organizations, but they have powerful ripple effects and elevate the level of domestic technology. Support from the government should be considered to attract foreign research institutes. Offering material incentives like land, building, and subsidies is critical because educational institutions are usually non-profit organizations. Developed countries also actively offer governmental support to induce famous institutions. A legal foundation to support foreign institutes should be clarified to provide the sufficient governmental support.

Instead of bringing in foreign institutes, the industry-academic collaboration system that utilizes domestic research professionals can be created. In case of Ireland, instead of attracting foreign research institutes to Ireland, they created industry-academic collaboration system between domestic universities and foreign companies in Ireland to secure the supply of skilled labor.

3.4. FDI Promotion System

To accelerate promotion of FDI, the above-mentioned conditions, the living conditions and the economic system that satisfies the global standard, should be created. At the same time, active and systematic FDI promotion strategies should be prepared.

Uzbekistan already has government agencies for FDI promotion: Ministry of Foreign Economic Relations, Investments, and Trades(MFERIT) and UzInfoInvest. MFERIT has been established by Presidential Decree "On Improvement of Management System in Foreign Economic and Trade Relations, Attracting Foreign Investment" on July 21, 2005. MFERIT guides overall general affairs of FDI and trade promotion, and objectives are promoting international economic activities and exports, attracting FDI, and expending international trade. UzInfoInvest is exclusively in charge of FDI promotion and information support service, and was established in 2007 by the initiative of the President of the Republic of Uzbekistan Islam Karimov with the primary purpose of providing a one-stop informational and all other possible support to foreign investors in Uzbekistan. It is an independent institution (legal entity) under the MFERIT. Main goal of UzInfoInvest is to promote foreign and domestic direct investment, and to spread the information about investment opportunities in Uzbekistan.

1) Integrated FDI Promotion Agency

After the FIEZ establishment, the Navoi FIEZ authority will independently promote FDI aside from activities of existing government FDI promotion agencies. To control FDI promotion activities more efficiently, an integrated system that works as a communication network linking all FDI promotion agencies should be created. By creating a network with this integrated system of all FDI promotion agencies, each FDI promotion agency can be assigned to a specified role and balance in FDI activities can be maintained. Searching for potential investors and collecting information about the international trends can be done by an agency that connects the domestic and foreign arenas. The Potential Investments Partners Search Team of UzInfoInvest can be dispatched abroad, disseminating investing opportunities in Uzbekistan while collecting information about movements of foreign capital.

Implementing the integrated FDI information system that combines information related to the Navoi FIEZ authority, the regional administration, and the FIEZ committee is advisable. Using this system, all policies can be efficiently deliberated and modified, and cases of multiple FIEZs competing to attract same foreign company can be prevented. Also, information about potential foreign investors can be shared by all FDI promotion agencies, and potential foreign investors can be provided with one-stop information services of all FIEZs.

2) Role Assignment of FDI Promotion Activities

It is important for MFERIT, UzInfoInvest, and the Navoi FIEZ authority to assume a distinctive role in FDI promotion activities. MFERIT is in charge of general management of FDI promotion activities, especially deciding on target industries of FDI promotion and creating cooperation system that connects FDI to target industries to related sectors like education, labor, and science and technology. UzInfoInvest educates foreign investment specialists and assigns them to FIEZ investment projects. Navoi FIEZ Authority precedes FDI promotion activities with foreign investment specialists as a project manager for each investment project. The regional FIEZ authority should be granted with more discretion about marketing (for example, setting land price and incentives) so that more effective promotion can be possible.

3) Perpetual and Focused FDI Promotion System

The FDI Promotion Committee, an independent committee for FDI, can be established to propose visions and strategies about FDI, to mediate the relationship between each FDI promotion agencies, and to support each agency to maximize its capacity. Investing on an industry that coincides with the initial vision of FIEZ establishment and has relatively broader economic impact will create the long-term growth power. Singapore strategically selects an industry to support and invests in one of most renowned companies of the industry. This way, Singapore attempts to introduce a new industry and support its development, and furthermore, to successfully cope with industry restructuring and to complement weakness of the domestic economy. IDA of Ireland also predetermines the target industry and focuses on the investment promotion of the industry.

Seeking consultation from advisors is also a good way to support FDI promotion. In case of Ireland, IDA is in charge of FDI promotion in all of Ireland, and to advise IDA, Science Foundation Ireland(SFI) has been established. SFI consults IDA about the issues on competitiveness of work force and technology to positively influence FDI promotion. Also, the Training and Employment Authority of Ireland(FAS) participates in decision-making process of Forfas, the National Policy and Advisory board of Ireland, to insure that policies related to labor, training, and employment are in accordance with industrial policies.

4. Summary and Policy Suggestions

The analysis of the Masan FTZ enables us to identify appropriate policies for success of Navoi FIEZs. In the case of Masan FTZ, the objective of policies tends to concentrate on the creation of a business-friendly environment. The Masan FTZ shows that the attractiveness of a Special Economic Zone is positively related to effectiveness of the government's effort. Thus, this section suggests several policies which the Uzbek government should focus on.

First of all, a specialization strategy to create business environment within the FIEZ should be implemented. The sharp differences between successful FIEZs and non-FIEZs can be seen in living conditions, economic freedom, currency exchange, and taxation. The following paragraphs provide an explanation of each factor in the specialization strategy for a successful FIEZ.

The FIEZ should maximize and guarantee economic freedom for business activities in the FIEZ, which serve to remove impediments in foreign investment. In other words, an FIEZ should be managed as an exclusive territory not subject to regular Uzbek laws. The economic freedom can be granted by providing several conditions-guarantee of independence, anti-trust act, corruption prevention, stable currency, and consistency of policy. Despite its traditionally restrictive laws on foreigners, the Dubai government supports economic freedom for foreigners in its FIEZs. The ease of business activities has been achieved by alleviation of restrictions on foreigners and taxation. Every regulation applied to the FIEZ should be reformed decisively. Strict regulations may cause conflicts with timely execution of the FIEZ development plan, and obviously the delayed development negatively influences investment from abroad. The laws in Navoi FIEZ related to environmental protection, construction restrictions, the labor market, the business environment, and the living conditions are redefined to favor foreign investors. Labor laws, such as labor restrictions on minimum wage, hiring and firing practices, and unemployment benefits, need to be adjusted to foreign firms in Navoi FIEZ. In addition to guaranteed flexibility of business activities in Navoi FIEZ, the stability of currency exchange should be maintained for foreign firms, since it impacts foreign investment positively. In other words, whenever they need to convert their domestic currency to the investing nation's currency, they should be able to exchange currency without any difficulties. Thus, the government should establish the policy to expedite the currency exchange. Also, preferential tax needs to be implemented to differentiate the business environment of Navoi FIEZ from non-FIEZs. To minimize transaction costs of business activities in Navoi FIEZ, the administrative system, the financial system, and the corporate structure should be organized in accordance with international standards. The improvement of living conditions is essential to helping foreign investors settle down and concentrate on business activities. The longer it takes to create the good living conditions, the longer it will take to attract foreign capital. Convenient transportation system and guaranteed security are the basic conditions. Also, housing, schools, and medical institutes should be built to facilitate the settlement. To attract foreign schools and medical institutions, eliminating possible obstacles like regulations and restrictions should be top priority.

Second, expedited development of essential infrastructure, such as transportation facilities, is essential for better flow of business activities. To expedite the build-up of infrastructure, a vertical system of regulation, direction, approval, and supervision needs to be replaced with integration of functions under the goal of supporting investments. In addition, the independence and autonomy of the Navoi FIEZ authority should be guaranteed by the grant of discretionary power over employment, organization, and budget. The Masan FTZ of Korea developed rapidly once surrounding infrastructure, including highways, was developed. The utilization of the national budget can provide infrastructure development with sufficient funds. The alleviation of construction laws and obligations for the assessment of environmental effects can simplify the process of infrastructure development.

Third, the legal status and characteristics of the Navoi FIEZ authority should be defined clearly prior to the development of FIEZs. Unlike the municipal government, the Navoi FIEZ authority is established for a special purpose. Thus, it has more control within the FIEZ than the municipal government. To guarantee the power of the Navoi FIEZ authority, the law about the establishment process and authority of the special regional administrative body needs to be enacted. Otherwise, the efficiency of FIEZ will be undermined by potential conflicts between the Navoi FIEZ authority and the municipal government. The role of Navoi FIEZ authority consists of searching for potential investors, marketing, offering administrative services, and attracting world renowned education and medical institutes. The existence of official institutions and organizations which can execute the law in a proper manner to support the foundation and operation of foreign firms is especially important in the early stage of FIEZs.

Fourth, the central government should set the direction of industrial policies, economic policies, and become the driving force for economic growth. Although the successful FIEZ is a given with independent decision-making authority, that autonomy does not mean complete independence on policy making. The central government should propose a development plan for Navoi FIEZ, which assigns a specific role to an FIEZ. In that way, the central government is able to maximize the potential of the Navoi FIEZ. To stipulate the growth of successful FIEZs, clear communication with the government should be developed to reflect the government vision. Lack of communication with the central government means disruption of collaboration between the Navoi FIEZ agency and the central government. In addition, vision and goal of Navoi FIEZ should be set according to the concrete circumstances of the national economy. In other words, they need to reflect on long-term perspective of national economic goals. Korea established the Masan Free Export Zone in the 1970s which coincided with the export-oriented economy policy. The economic policy should be designed in a way that maximizes benefits and gains from linkage. Local companies can develop their technological capabilities through active business with foreign firms in the FIEZ. Eventually, the industrial structure of the national economy will be upgraded. In case of the Masan FTZ, firms within the FTZ outsourced various processes of manufacturing to local companies. Moreover, the linkage can ease the unemployment problem because the huge demand of foreign firms for labor benefits the local employment.

Fifth, supplying sufficient labor force and sustaining competitive wage levels are the essential means for attracting foreign investment. Flexibility of the labor market should be guaranteed by easy hiring and firing. In case of Shenzhen SEZ of China, employees can be fired not only for breach of contract but also as a part of restructuring. In addition, it is recommended that the salary is determined by the discretion of companies. The differentiation in salary levels should be legally guaranteed. In the early stage of Navoi FIEZ, cheap labor in emerging markets can have the greatest appeal for foreign companies, so we recommend that the wage be sustained at a comparable level. To provide sufficient number of skilled labor, educational institutions should be built in Navoi FIEZ so that job training programs are offered to the work force. A well-designed employee training program will secure a stable supply of skilled labor. The educational institutions can collaborate with foreign firms by focusing on research. The research institutions have powerful ripple effects on industry, since they elevate the level of domestic technology. The government support, such as material incentives and subsidies can be utilized to attract foreign research institutions into the FIEZ. Instead of bringing in foreign institutions, the government can hire domestic research professionals to improve its industry-academic collaboration system. In the case of Ireland, the government depends on domestic universities for industrial research.

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Chapter 04

An Analysis of the Legal Aspects of the Navoi FIEZ

1_ Introduction
2_ Legal Framework for Free Economic Zones in Uzbekistan
3_ Legal Framework for Free Trade Zones in Korea
4_ International Rules on FEZs
5_ Conclusion: Implications and Recommendations for the Navoi FIEZ

Chapter 04

An Analysis of the Legal Aspects of the Navoi FIEZ

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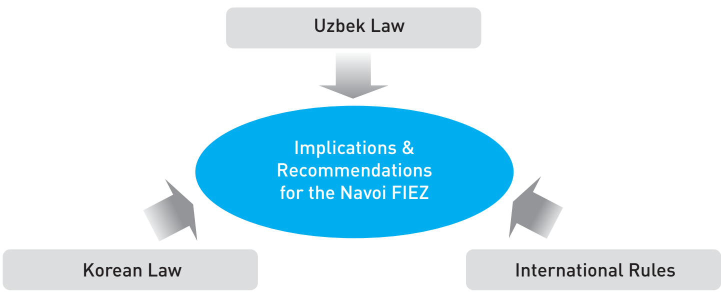
1. Introduction

Every government's reform in any sphere necessitates the adoption of legal instruments which bring about legally binding rules that are able to put the anticipated reforms into practice. The same is true for Free Economic Zones(hereinafter "FEZs"). More than 100 countries[1] around the world that have established FEZs have their own legislation regulating a wide range of issues such as establishment or closure of such zones, requirements imposed on economic entities within the zone, various tax or customs incentives, administrative procedures and so on. Not surprisingly, the Republic of Uzbekistan(hereinafter "Uzbekistan") has also followed this "standard" practice by introducing a number of laws and regulations concerning foreign investment promotion measures in general and FEZs in particular.

As illustrated in Figure 4-1, this Chapter aims to examine legal aspects of the Navoi Free Industrial Economic Zone(hereinafter the "Navoi FIEZ") from three different perspectives.

Figure 4-1 | Main Concept of this Chapter



1. See Annex 1 of this Chapter.

First, it will analyse the Uzbek legal framework for FEZs. Second, it will examine FEZ-related rules of the Republic of Korea(hereinafter "Korea"). Third, it will look into international disciplines that are applicable to FEZs. The ultimate purpose of such a three-tier comparative analysis is to identify the areas in the Uzbek regulatory framework that could be rectified, supplemented or otherwise improved. Possible implications and recommendations for the Navoi FIEZ conclude this Chapter.

2. Legal Framework for Free Economic Zones(FEZs) in Uzbekistan

2.1. Introduction to the Uzbek Legal System

2.1.1. General Characteristics

The current legal system of Uzbekistan belongs to continental law which is characterized by the following factors: First, it is a written law(statute) that is the main source of law. Accordingly, the principle of precedence(case law) does not apply. Moreover, all branches of Uzbek law are codified; Second, sources of law are placed in the strict hierarchy of norms with the Constitution on the top of it; Third, the Constitution and laws have absolute supremacy in Uzbekistan implying that the state, its bodies, public officials, juridical and natural persons must act in accordance with the Constitution and laws. Fourth; Uzbekistan incorporated fundamental principles of judicial system and procedures of continental law. The judicial power in Uzbekistan is represented by the Constitutional Court, the Supreme Court, the Higher Economic Court, and subsidiary courts.[2]

2.1.2. Main Rule-Making Bodies

Oliy Majlis(Parliament)

The Oliy Majlis(parliament) is Uzbekistan's legislative body consisting of two chambers: the Legislative Chamber(lower chamber) with 150 members and the Senate(upper chamber) with 100 members. The term of both chambers is five years. The Legislative chamber works on a permanent, professional basis, while the Senate meets on a sessional basis. The two chambers adopt or amend the Constitution and laws together, while each of them adopts resolutions on issues of respective jurisprudence.

President

The President is the head of state and ensures coordinated operation and interaction between the government entities. The President is elected for seven years and can serve up to two

2. See Saidov A., Comparative Law [in Russian], Tashkent: Adolat, 1999, pp. 454-456.

consecutive terms. The President nominates the Prime Minister who has to be approved by the Oliy Majlis. Other members of the Cabinet of Ministers, except the chairman of the State Committee of Nature Protection, are appointed by the President upon nomination by the Prime Minister. Decisions of the President are issued in the form of decrees, resolutions or orders.

Cabinet of Ministers(Government)

The Cabinet of Ministers is the collegial executive body which provides guidance for economic, social and cultural development as well as for the execution of the laws enacted by the legislative branch. The Cabinet of Ministers consists of the Prime Minister, his/her deputies, ministers and chairmen of state committees. The Prime Minister is the head of the Cabinet of Ministers and reports to the President and the Oliy Majlis. The Cabinet of Ministers issues various resolutions and orders.

Administrative Bodies

At present, there are 14 ministries, 9 state committees and 8 agencies that also take part in the rule making process in Uzbekistan. They take decisions on the issues falling within the scope of their competence.

Local Authorities

Uzbekistan consists of 12 administrative regions(“viloyat”), the city of Tashkent and the Republic of Karakalpakstan, which are in turn composed of districts(“tuman”), cities, towns, and villages(“kishlak, aul”). In each of these 14 administrative regions and sub-administrative divisions(districts, cities), executive power at the local level is exercised by governors (“khokim”). The regional governors are appointed by the President subject to approval by the locally elected Councils of Deputies(“kengash”). The regional governors then appoint the lower level governors. The term of office of Councils of Deputies and governors is 5 years. Local authorities are responsible for, inter alia, promoting trade and foreign direct investment to the regions, including the establishment of joint ventures and enterprises with the participation of foreign investment. Within their competence, governors issue decrees, orders, and instructions enforceable in the given region.

2.1.3. Normative Hierarchy

The Uzbek legal system is based on a hierarchy of rules. Rules may be normative (binding and of general applicability) or non-normative (binding upon a specified person(s) only). Normative rules are introduced, modified or terminated by “normative-legal acts” that according to the Law on Normative-Legal Acts (2000) are placed in the hierarchy as follows:

- Constitution
- Laws
- Resolutions of the Oliy Majlis (parliament) chambers
- President’s decrees

- Cabinet of Ministers' resolutions
- Ministerial and state committee's documents
- Decisions of local governments

The first three categories in the legal hierarchy above are referred to as "legislative acts," with the remaining four documents called "sub-legislative acts." Legislative acts are adopted by the parliament, while sub-legislative acts are adopted mainly by executive bodies.

The Constitution is the supreme law of Uzbekistan that recognizes basic human rights, and defines the political system and the administrative structure of the country. Laws are statutory prescriptions determined by the parliament. Laws that incorporate and systematize a comprehensive set of rules within a particular branch of law take the form of codes, such as the Civil Code, the Criminal Code, the Labour Code etc. Resolutions of the Oliy Majlis chambers concern specific issues of political, social or economic life as well as internal or external policy.

The main principle underlying the legal hierarchy is that each subordinate act must implement a higher act and comply therewith. Should one act contradict another, there arises a conflict of norms within the legal system. Article 14 of the Law on Normative-Legal Acts sets forth three principles of conflict resolution. First, if two or more normative-legal acts conflict, the act with a higher legal status takes precedence. Second, if acts with the same status are in conflict, the latest act precedes. Third, should documents of ministries or state committees of the same level(e.g. orders or resolutions) contradict each other, the document of the ministry or state committee that is in charge of the subject matter prevails.

2.2. Uzbekistan's Legislation on FEZs

This section provides an overview of Uzbekistan's legal provisions dealing with FEZs. The existing national rules can be divided into (1) principal disciplines that directly address FEZ-related issues, and (2) supplementary disciplines that do not address FEZs as such, but are still applicable to the FEZ to the extent not covered by the principal disciplines. Due to spacial restraints, the review of the second normative category is confined only to rules that are most pertinent to the operation of the Navoi FIEZ.

2.2.1. Principal Disciplines

The Law on Free Economic Zones(1996) (hereinafter the "FEZ Law") is a main framework legislative act for FEZs. Article 1 of the Law defines an FEZ as a special designated territory with clearly distinguished administrative borders and a special legal regime designed to attract domestic and foreign capital, progressive technology and governance expertise for the sake of accelerated social and economic development of the zone. The Law distinguishes mainly three types of FEZs, i.e. free trade zones, free industrial zones and free scientific-technical zones, but does not rule out other types of zones. It provides for the establishment and closure of FEZs, a framework legal regime within FEZs, and basic FEZ governance principles.

With the launch of the Navoi FIEZ, new instruments were adopted, notably:

- The President's Decree on Formation of a Free Industrial Economic Zone in the Navoi Region, No. UP-4059, 2 December 2008(hereinafter the "President's Decree");
- The Cabinet of Ministers' Resolution on Measures of Organizing the Operation of the Navoi FIEZ, No. 21, 27 January 2009(hereinafter "Resolution No. 21");
- The Cabinet of Ministers' Resolution on Approval of the Regulations for Simplified Entry/Departure/Stay/Employment Procedures for Foreigners and Stateless Persons in the Territory of the Navoi FIEZ, No. 104, 9 April 2009(hereinafter "Resolution No. 104");
- The Cabinet of Ministers' Resolution on Measures of Regulating the Operation of the Navoi FIEZ, No. 105, 9 April 2009(hereinafter "Resolution No. 105");
- The Cabinet of Ministers' Resolution on Approval of Provisions for Special Customs Regime and Regulations of Securing Special Tax Regime in the Territory of the Navoi FIEZ, No. 120, 23 April 2009(hereinafter "Resolution No. 120").

The President's Decree has brought the Navoi FIEZ into existence. According to the Decree, the purpose of the Navoi FIEZ is to create a favourable environment for foreign investments (predominantly FDIs), nurture of modern high-tech industries, and development of industrial potential, manufacturing, transport and social infrastructure in the Navoi region. The Decree sets forth a number of customs and tax incentives that vary depending on the amount of investment. The remaining documents on the list above implement the President's Decree by specifying, in more detail, various administrative and procedural issues linked to the Navoi FIEZ operation.

Resolution No. 21 approves the location of the Navoi FIEZ proposed by the Navoi governor's office("khokimiyat"), the Navoi FIEZ statute, and outlines a number of measures for creating necessary facilities in the zone. In particular, the Navoi FIEZ statute provides for the management system of the zone (functions and competence of the Administrative Council and the Directorate), economic activities and special legal regime in the zone. The Administrative Council consists of senior-level government officials and coordinates the overall function of the zone. The Directorate is in charge of the operational management of the zone.

Resolution No. 104 sets forth streamlined procedures for entry, departure, residence and employment of foreigners or stateless persons in the Navoi FIEZ. Entry visas are issued on the basis of a Directorate's written petition for up to one year or the period of the work permit. Foreigners and stateless persons generally stay at housing facilities which are constructed for this purpose in the territory adjacent to the zone. They are required to obtain temporary residence permits from local authorities on the basis of a Directorate's written petition. Work permits are issued for up to one year with possible extensions. The Resolution in question shortens time limits, simplifies procedures, and empowers the Directorate to facilitate the procedures concerned. No fees are charged for visas and visa extensions, temporary residence registration, and issuance of labour licenses and work permits.

Resolution No. 105 establishes the statute of the Administrative Council, rules on selection of investors for the Navoi FIEZ, and registration of residents of the zone. The mission of the Administrative Council is to coordinate the work of various government agencies in matters related to the zone, determine its mid- and long-term development strategies, oversee Directorate's activities, examine investment applications and so on. The selection of investors who wish to be located in the zone consists of two stages: (1) submission of investment applications (for setting up of production in the zone) to the Directorate, and (2) examination of those applications by the Administrative Council. In this selection process, preference is given to the projects providing full cycle of production on the territory of the zone through creation of juridical persons cooperating in consecutive technological processing of raw materials and semi-final items in production of finished goods. Once selected, the investors have to conclude investment agreements with the Directorate and complete state registration as the resident of the zone.

Resolution No. 120 introduces special customs and tax rules for residents of the Navoi FIEZ. The customs rules stipulate that equipment, raw materials and spare parts for production of goods for exports brought by residents into the zone are exempt from customs duties and economic policy measures(applicable to foreign goods), or deemed to be exported(applicable to domestic goods). For imported raw materials or spare parts used in production of goods for domestic market, customs duties are paid in amount of 50% of the existing rates. Tax incentives foreseen by the President's Decree to residents of the zone are reintroduced by the tax rules of Resolution No. 120. Notably, the residents are exempt from the land tax, property tax, profit tax, social infrastructure development tax, as well as unified tax payment(for small enterprises), compulsory payments to the Republican(national) Road Fund and the Republican(national) School Fund, depending on the amount of their direct investments brought to the FIEZ, as follows:

- In the amount from 3 to 10 million Euros - for 7 years;
- From 10 to 30 million Euros - for 10 years. Over the next 5 years the rates of profit and unified taxes payment will be fixed at 50 percent level below current rates;
- More than 30 million Euros - for 15 years. Over the next 10 years the rates of profit and unified taxes payment will be fixed at 50 percent level below current rates.

2.2.2. Supplementary Disciplines

Investment

Table 4-1 | **Selected Guarantees for Foreign Investors in Uzbekistan**

Guarantees	Brief Description	Provision
Non-discrimination	Prohibition of discrimination based on investor's nationality, residence, religion, or place of conducting economic activity	Art 3, Foreign Investment Protection Law
	National treatment for foreign investments	Art 9, Foreign Investment Law
Prevention of "injurious" law	• No retroactive application of laws causing injury to investors or investments • Continuous application of an "old" law within 10 years of the investment date if a "new" law worsens the conditions for investment;[3] but the investor may apply provisions of "new" law improving the conditions for investment	Art 3, Foreign Investment Protection Law
Ownership guarantees	• Prohibition of nationalization • Requisition banned except in emergency cases and subject to compensation	Art 5, Foreign Investment Protection Law
Financial guarantees	• Free use of investment revenues • Right to use bank accounts, take/pay loans in foreign currency • Free remittance of foreign currency subject to taxes and other charges • Right to repatriation of investor's assets after termination of investment activity	Arts 6-8, Foreign Investment Protection Law
Access to information	Access to and publication of legislation and court decisions affecting investor's interests	Art 9, Foreign Investment Protection Law
Dispute Settlement	• Investment disputes to be settled by consultations, Uzbek economic courts, or international arbitration • Non-investment disputes to be settled in accordance with Uzbek legislation unless treaties provide otherwise	Art 10, Foreign Investment Protection Law
Remedies	Compensation, through judicial procedures, for damages caused by violations of the Foreign Investment Protection Law or illegal conduct of state organs	Art 11, Foreign Investment Protection Law
Conflict of rules	Most favourable provisions to prevail in case of conflicts between the Foreign Investment Law/Foreign Investment Protection Law and other domestic rules or international agreements	Art 22, Foreign Investment Law Art 12, Foreign Investment Protection Law

Source : Drawn up by the author.

3. Pursuant to Article 3 of the Foreign Investment Protection Law, the worsening of investment conditions means:
- increasing the withholding tax rate on dividends payable to the foreign investor;
- introducing additional requirements making repatriation more complicated or decreasing the amount of profits (income) of foreign investors transferred abroad;
- introducing limitations on the size of investment as well as increasing the minimum size of statutory capital for enterprises with foreign investments;
- introducing restrictions on shareholding by the foreign investor in the statutory capital of the enterprise;
- introducing additional procedures for visas for foreign investors as well as additional requirements for conducting foreign investments.

General investment regulations apply in the FIEZ to the extent the principal disciplines do not provide otherwise. At least three laws are relevant.

The Law on Investment Activities(1998) provides legal definitions for "investment," "investment activity," "investor," "participant of investment activity," and "re-investment;" specifies forms and objects of investment, investor's rights and obligations; and provides for protection of investors.

Unlike this Law which is applicable to both local and foreign investors, the Foreign Investment Law(1998) and the Law on Guarantees and Measures of Protection of Foreign Investors' Rights(1998) (hereinafter the "Foreign Investment Protection Law") are pertinent to foreign investors only. Pursuant to Article 5 of the Foreign Investment Law, foreign investments may take the form of share holding in enterprises, complete ownership of enterprises, purchase of securities, contributions to intellectual property, concessions and others. The Foreign Investment Protection Law supplements the Foreign Investment of Law elaborating on a number of guarantees outlined in Table 4-1.

Uzbekistan adopted Article 8 of the International Monetary Fund in October 2003, and liberalized currency convertibility on current account transactions and abolished the practice of multiple exchange rates. Current account transactions are mainly related to foreign trade and to repatriation of dividends.[4)]

Foreign investors are guaranteed transfer of funds in foreign currency to and from Uzbekistan without any limitations provided they have paid taxes and other obligatory payments in accordance with the procedures established by legislation. Such transfers include the followings:[5)]

- Initial and additional sums designed either to support or to increase foreign investments;
- Income received from investments;
- Funds received as compensation for losses inflicted in accordance with the legislation;
- Payments executed according to agreements;
- Proceeds of sales of all or part of foreign investments;
- Payments arising from dispute settlements including any judicial or arbitral decision;
- Salary and other payments to workers;
- Funds from other sources received in accordance with the legislation.

As with general international practice, Uzbekistan may stop the repatriation of a foreign investor's funds in the event of insolvency and bankruptcy of an enterprise with foreign investments or the protection of creditors' rights, criminal acts or administrative infringement of a law by a foreign investor-natural entity, or when it is necessary to stop such repatriation according to arbitration or a court decision.[6)]

4. UNDP, Investment Guide to Uzbekistan 2009, p. 51.
5. Ibid., p. 59.
6. Ibid.

Pursuant to Cabinet of Ministers' Resolution No. 245(29 June 2000), enterprises in Uzbekistan are generally obliged to sell 50% of their foreign-exchange proceeds obtained through de-centralized export of their goods or services to authorized domestic banks. A five-year exception is granted to certain enterprises with foreign investments producing consumer goods.

As of August 1st, 2008, Uzbekistan signed 49 bilateral investment treaties dealing with the scope and definition of investment, admission and establishment, non-discrimination, fair and equitable treatment, compensation of damages to investors, prohibition of expropriation, guarantee of transfer of funds, dispute settlement mechanisms and other issues.[7] These international instruments supplement national standards of protection of foreign investors.

The main government body in charge of foreign investments in Uzbekistan is the Ministry of Foreign Economic Relations, Investments and Trade(MFERIT). In 2007, the President of Uzbekistan established UZINFOINVEST- an information support and foreign investment promotion agency under the MFERIT. This agency, inter alia, provides one-stop information services on all aspects of the existing investment climate(including national legislation) and investment potential of Uzbekistan, organizes investment and business forums and exhibitions, and runs a trilingual website <http://www.uzinfoinvest.uz>. In addition, the Ministry of Justice has a Department on Legal Protection of Foreign Investment and Enterprises with Foreign Investment which monitors violations of foreign investor's rights, makes recommendations to the head of an offending agency on termination of such violations or ultimately brings the case to national courts to protect the infringed rights of investors.

Customs and Taxes

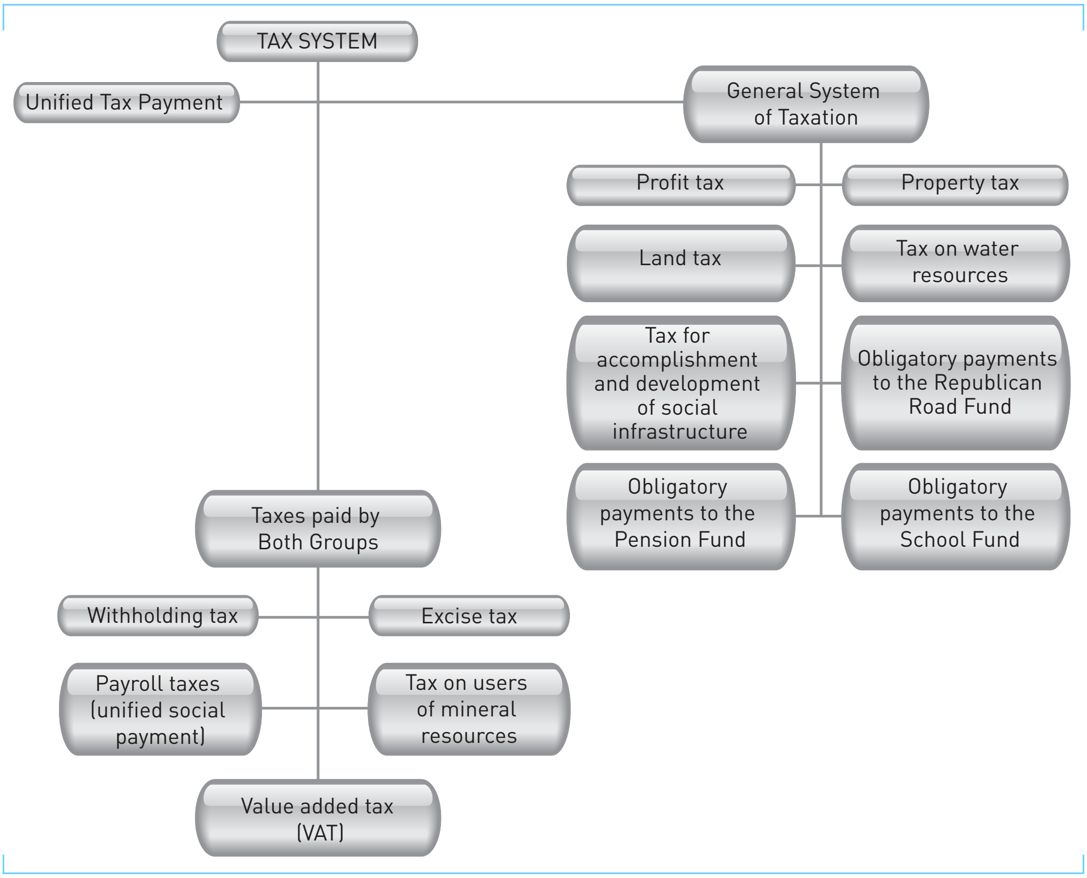
Economic operators registered in the Navoi FIEZ are provided with various customs and tax incentives identified in the President's Decree and specified in subsequent government resolutions. At the same time, general rules of taxation and customs procedures that do not contradict special regulations will continue to apply in the Navoi FIEZ.

The Customs Tariff Law (1997) and the Customs Code (1998) are two major legal documents that lay down principles and rules of Uzbekistan's customs policy and customs administration. The former determines the scope and features of customs, customs valuation methods, rules of origin, and general principles of granting tariff incentives and preferences. The latter is a more comprehensive document covering a broad range of issues, such as customs control, customs procedures, customs charges, liability and others.

The Tax Code (2007) sets forth detailed rules on taxation and each type of taxes. The current taxation system for companies operating in Uzbekistan is applicable to Navoi FIEZ resident enterprises. Notably, enterprises registered in Uzbekistan are subject to (1) unified tax payment or general system of taxation, and (2) common taxes, as illustrated in Figure 4-2.

7. Ibid., p. 60

Figure 4-2 | Enterprise Taxation System of Uzbekistan



Source : UNDP, *Investment Guide to Uzbekistan 2009*, p. 44, as modified by the author.

As a general rule, micro-firms and small enterprises, wholesale/retail/catering enterprises, brokerages, procurement enterprises and enterprises providing services under commission contracts pay the unified tax payment which is in lieu of: profit tax; property tax; obligatory payments to the Pension Fund, the School Fund, and the Republican Road Fund; tax on water resources; land tax; and tax for accomplishment and development of social infrastructure. The standard unified tax payment rate in 2010 is 7% of gross turnover. Micro-firms and small enterprises may, however, choose to remain under the general system of taxation. All other enterprises not covered by the unified tax payment have to pay taxes under the general system of taxation. Additional taxes common for all taxpayers include withholding tax, payroll taxes, excise tax, and tax on users of mineral resources.[8)]

Labour Issues

The employment of Uzbek citizens or foreigners in the Navoi FIEZ is generally regulated by the Labour Code (1995) and other labour laws and regulations. Accordingly, national standards

8. For details on the Uzbek taxation system, see UNDP, supra note 4, pp. 44-50.

for working hours, labour contract, employer/employee's rights and obligations, payment, liability etc. contained in those rules equally apply in and outside the Navoi FIEZ provided that collective or individual labour contracts do not provide more favourable treatment to employees in the zone.[9] Companies intending to recruit foreigners must obtain a foreign labour licence from the Agency for Foreign Labour Migration Affairs under the Ministry of Labour and Social Protection. On the basis of the labour licence, the Agency also issues confirmation for employment(work permit) for a foreign employee.

Others

As long as not otherwise provided, civil law, commercial law, financial law, criminal law, and all other laws and regulations that apply in the territory of Uzbekistan are equally applicable to and within the Navoi FIEZ.

3. Legal Framework for Free Trade Zones(FTZs) in Korea

3.1. Legal Basis in a Nutshell

As with Uzbekistan, Korea belongs to the continental law system. The Korean legal system is led by the Constitution(1948), followed by "Acts"- legal documents enacted by the National Assembly (the one-chamber parliament). When a law is passed by the National Assembly and sent to the executive branch, the government promulgates it, upon approval of the President, by publishing the text in the Official Gazette of the Government. Presidential "Enforcement Decrees" are subordinate legislations made by the Cabinet or the State Council composed of the ministers to implement Acts. Below those are "Regulations" or "Rules"- ordinances written by each Ministry to implement practical details, such as e.g. how to fill out certain forms, in accordance with a law and a presidential decree thereunder.

At present, the Korean legal framework for free zones largely consists of laws and regulations related to both (1) foreign investment and (2) free trade zones(FTZs) or free economic zones(FEZs). These include, in particular: (1) the Foreign Investment Promotion Act(1998) and the presidential Enforcement Decree of the Foreign Investment Promotion Act(1998), (2) the Act on Designation and Management of Free Trade Zones(2004) and the presidential Enforcement Decree of the Act on Designation and Management of Free Trade Zones(2004), (3) the Act on Designation and Management of Free Economic Zones(2002) and the presidential Enforcement Decree of the Act on Designation and Management of Free Economic Zones(2003). In addition, unless these instruments provide otherwise, the Foreign Exchange Transactions Act(1998) applies to matters related to foreign exchange and external dealings related to foreign investments, and the Special Tax Treatment Control Act(1998) applies to tax reductions for foreign investments.

9. See Article 16 of the FEZ Law.

Since foreign-capital invested companies are local corporations established under domestic law, the same laws that apply to purely domestic corporations apply even if the foreign-capital invested company has gone through the processes as prescribed in the Foreign Investment Promotion Act. Therefore, if approval and permission under each law are required, the relevant business may be conducted only after the required processes are completed.

3.2. Korean Legislation on Foreign Investments

3.2.1. Principal Instruments

The Foreign Investment Promotion Act and corresponding presidential Enforcement Decree have been enacted to facilitate foreign investments through support and provision of convenience for foreign investment. Foreign investments in Korea can take the form of (1) acquisition of a local company's stocks or stakes by a foreigner for the purpose of establishing a continuous economic relationship with and participating in the management of the given Korean company; (2) a loan of not less than five years provided by an overseas holding company and other entities to a foreign-capital invested company in Korea; or (3) foreigner's contribution to a non-profit organization.[10] The main foreign investment-related terms used in Korean investment law are defined in Table 4-2.

Table 4-2 | Basic Foreign Investment Terminology

Terminology	Definition
Foreign National	• An individual with foreign nationality; • A corporation established under a foreign law (foreign corporation); • An international economic cooperation organization: - An agent of a foreign government's external economic cooperation operations - International organizations such as the IBRD, IFC, ADB etc. which handle development credit - An international organization handling or executing by proxy external investments • A citizen of the Republic of Korea who has acquired foreign citizenship
Foreign Investor	A foreigner holding shares etc. or having made a contribution as prescribed in the Foreign Investment Promotion Act
Foreign-capital invested Company	A company into which a foreign investor makes an investment, or a non-profit organization into which foreign investors have made a contribution
Investment Object	An investment (investment vehicle) made by a foreign investor as defined by the Foreign Investment Promotion Act to hold shares etc. which qualifies as one of the following: • A domestic payment vehicle resulting from an external payment vehicle under the Foreign Exchange Trade Act or the exchange of such an external payment vehicle; • Capital goods;

10. Article 2.4 of the Foreign Investment Promotion Act.

	• Profits(dividends) from shares acquired through foreign investment; • Industrial property rights, intellectual property rights(copyrights, semiconductor integrated circuit placement rights), and others including corresponding technologies and usage rights for such technologies; • Remaining property to be distributed to the foreign national from the liquidation of domestic branches, offices, or corporations owned by a foreign national; • Repayment of loans or other external debts; • Foreign corporate shares listed or registered in overseas securities markets; • Shares held by a foreigner under the Foreign Investment Promotion Act, or the Foreign Exchange Transactions Act; • Domestic real estate owned by a foreigner; or • Funds from the disposal of shares and/or real estate of a domestic business owned by a foreigner.
Capital Goods	• Machinery, equipment, facilities, furniture, components, parts for industrial facilities, and livestock, seeds, trees, fish and shellfish required for the development of agricultural, forestry, and fishery industries; • Other materials and spare parts recognized by the relevant ministry as required for an initial test operation of the said facilities; or • Freight and insurance costs required to import the above, or technologies or services for installation or advices Freight and insurance costs required to import the above, or technologies or services for installation or advices

The law in question provides a package of guarantees and support measures directed at promotion of foreign investment in Korea. First, foreign investors and foreign-capital invested companies are accorded national treatment. In particular, unless otherwise stipulated by an Act, tax exemptions or reductions provided to Korean citizens(corporations) equally apply to foreign investors or foreign-capital invested companies. Second, the law guarantees overseas remittances of investment proceeds. The Minister of Strategy and Finance may temporarily suspend or restrict foreign exchange transactions or impose an obligation to safekeep, deposit or sell means of payment or precious metals in or to the Bank of Korea, government agencies, the Foreign Exchange Equalization Fund, or financial institutions, provided that these measures are unavoidably required due to force majeure(war, calamities etc.), substantial and drastic changes to internal and external economic conditions, or other relevant matters. However, these exceptional measures do not apply to foreign investments, and this is explicitly inscribed in the Foreign Exchange Transactions Act.[11] Accordingly, overseas remittance by foreign investors is fully guaranteed.

3.2.2. Foreign Investment Support Measures

Lease and Sale of State and Public Properties

State and public properties may be leased for up to 50 years, or sold to foreign-capital invested companies through free (private) contracts. If a foreign-capital invested company which wishes to purchase a state or public property is acknowledged to have difficulty in

11. Article 6 of the Foreign Exchange Transactions Act.

making a lump-sum payment of the purchase price, the payment may be deferred or made in installments. In case of a lease of the land owned by the central or local government, the building of a factory or other permanent facilities on the land may be allowed, provided that the factory/facilities will be contributed to central or local government or be completely removed. The Minister of Strategy and Finance, administrative agencies in charge of managing state properties, and the heads of local governments may reduce or exempt the rental fee of the leased state and public properties.[12)]

Cash Support

For foreign investments that satisfy certain conditions, the state and local governments may furnish funds required for certain uses, including the construction of new factories. In considering whether or not to provide cash grants, the Korean authorities take into account various factors, such as whether foreign investments accompanies high technologies, the effect of technology transfer, the number of jobs created, redundancy with internal investments, adequacy of location and others. Grants may be used only for land purchase or lease, construction costs, installation cost of infrastructure(electricity, communication facilities etc), purchase cost of capital goods or research equipment, and employment or education training. Cash grant is paid in a lump sum within a year or in a ten times installment within five years.[13)]

Reward for Attraction of Foreign Investment

The head of a local government or the head of a government organization may give a reward to any person who is recognized as being greatly credited with attracting foreign investment. The rewarding conditions are prescribed by respectively the municipal ordinance of the relevant local government or the Minister of Knowledge Economy.[14)]

Investment Promotion Offices

The main investment policy-making organ in Korea is the Foreign Investment Committee comprising the heads of various ministries and chaired by the Minister of Knowledge Economy. This committee considers important matters concerning foreign investment policy, coordination of intra-agency measures related to improvement of investment climate, matters concerning tax breaks, cash support measures and other affairs.[15)]

The Foreign Investment Promotion Act established a Foreign Investment Support Center under the Korea Trade-Investment Promotion Agency(KOTRA) with the mandate to provide consultations, guidance, advertisement, research, and treatment of civil petitions. In addition, the Act gives the birth to an ombudsman for foreign investment who is in charge of grievance

12. Article 13 of the Foreign Investment Promotion Act.
13. Article 14-2 of the Foreign Investment Promotion Act and Article 20-2 of the Enforcement Decree of the Foreign Investment Promotion Act.
14. Article 14-3 of the Foreign Investment Promotion Act.
15. Article 27 of the Foreign Investment Promotion Act.

settlement in foreign-capital invested companies. Moreover, central and local administrative agencies may establish their own foreign investment promotion offices.[16)]

Grievance Resolution System

Besides general means of resolving investment-related disputes, such as administrative or judicial procedures, both the Foreign Investment Promotion Act and the Act on Designation and Management of Free Economic Zones provide for grievance settlement by an ombudsman for foreign investment. The Office of the Foreign Investment Ombudsman(OIO) was established in October 1999 to address management and daily-life difficulties experienced by foreign investors in Korea and to improve the overall business climate. It is a non-profit organization operating under the KOTRA. In addition, ombudsmen are to appointed in the administrative body of free economic zones.[17)]

The foreign investment ombudsman is commissioned by the President on the recommendation of the Minister of Knowledge Economy, via the deliberation of the Foreign Investment Committee, among persons who have extensive knowledge and experience in foreign investment activities. The term of office of the foreign investment ombudsman is three years, but reappointment is possible.[18)] The foreign investment ombudsman's mandate includes:[19)]

- Collection of information concerning problems experienced by foreign-capital invested companies;
- Preparation of policy measures for improving the foreign investment system and recommendation of the implementation thereof to relevant administrative agencies; and
- Other necessary matters for assisting foreign-capital invested companies in solving their problems.

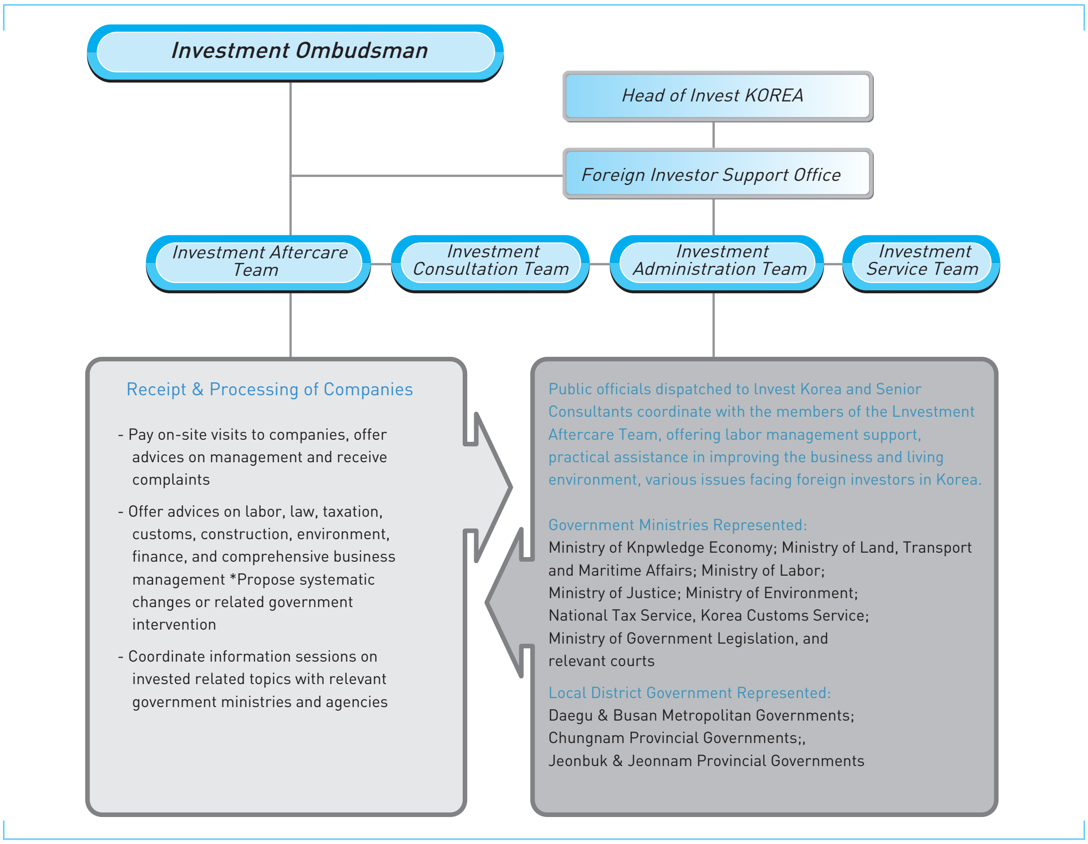
Korean law requires prompt cooperation from relevant agencies. Notably, the ombudsman may request the relevant administrative agency or the foreign investment-related agency to cooperate for the purpose of solving problems faced by foreign-capital invested companies and performing duties relating thereto. In this case, the cooperating agency must notify its opinion on the matter under consideration within seven days after the date on which the request has been made.[20)]

Between 2000 and 2007, the OIO received more than 3,200 grievance cases dealing with construction, finance, tax, labor, IT, accounting, law, logistics, investment procedures and other

16. Articles 15, 15-2, and 16 of the Foreign Investment Promotion Act.
17. Article 28 of the Act on Designation and Management of Free Economic Zones.
18. Article 15-2(2) of the Foreign Investment Promotion Act, and Article 21-4(1) of the Enforcement Decree of the Foreign Investment Promotion Act.
19. Article 21-4(2) of the Enforcement Decree of the Foreign Investment Promotion Act.
20. Article 21-3, paragraph 3 of the Enforcement Decree of the Foreign Investment Promotion Act.

issues. Most of these cases have been processed either directly by the OIO's "home doctors" or through recommendations to the relevant government bodies seeking their cooperation or revision of regulations.[21]

Figure 4-3 | OIO Organization



Source : OIO, (http://www.i-ombudsman.or.kr)

As shown in Figure 4-3, the OIO has two separate divisions - the Investment Aftercare Team and the Investment Service Team. The Investment Aftercare Team consists of the OIO "home doctors"- private sector specialists in construction, finance, tax, labor, IT, accounting, law, logistics, etc. They are assigned to foreign-capital invested companies operating in Korea to provide personalized assistance in resolving a variety of management grievances by tackling bureaucratic red tape and cumbersome administrative procedures.

The Investment Service Team undertakes projects aimed at improving the overall foreign investment environment, with a particular focus on addressing the daily living inconveniences

21. See Office of the Foreign Investment Ombudsman, <http://www.investkorea.org/InvestKoreaWar/work/ombsman/eng/au/index.jsp num=3> (visited 1 January 2010).

commonly experienced by foreign business executives and their families. Major activities include personalized settlement services for newly arriving foreign investors, seminars, cultural tours, annual publications, and foreign investor surveys aimed at enhancing Korea's standing as a friendly and comfortable location for doing business.

3.3. Korean Legislation on FTZs

The history of legal regulation of free zones in Korea goes back to 1970 when the Act on Establishment of Free Export Zones was enacted. Article 2.1 of this Act defined "free export zone" as an area having the characteristics of a bonded area where the application of pertinent laws and regulations was waived or relaxed in whole or in part. Article 9 stated that in order to operate in this zone, located enterprises had to produce for export, and be either a wholly foreign-capital invested enterprise or a joint-venture. The Act provided for the designation of the zone, constructions in the zone, the functions of the zone's administration, sale and lease of land and other property, entry and exit requirements and other issues.

Currently, the Korean legislation generally distinguishes three types of sites with attractive environment for foreign investments. These are foreign investment zones, free trade zones and free economic zones.

Foreign investment zones refer to specially designated areas where the state government provides various incentives such as reduction and exemption of taxes and rents and mitigates administrative regulation for the purpose of inducing investment of a certain or larger size that contributes to the Korean economy through the advancement of industry, technology transfer, job creation, etc. Foreign investment zones take the form of either a complex-type area or individual-type area. Complex-type foreign investment zones are designated exclusively for the purpose of renting or transferring land therein to foreign-capital invested companies from among national industrial complexes and general local industrial complexes by city(Si) mayors and province(Do) governors after going through deliberation by the Foreign Investment Committee.[22] Basically, this type of foreign investment zone aims to attract small- and medium-sized foreign-capital invested companies. Individual-type foreign investment zones refer to those in which any foreign investor hopes to make its investment and which are designated by Si mayors and Do governors.[23] These zones are designed to attract large-scale investments. As of August 2009, there have been 13 complex-type and 29 individual-type areas.

Free trade zones(FTZs) are areas in which free activities of manufacture, logistics, distribution and trade are guaranteed with the legal assistance of special cases prescribed by the Customs Act, the Foreign Trade Act and other relevant Acts. They are designated by the

22. Article 18(1)1 of the Foreign Investment Promotion Act.
23. Article 18(1)2 of the Foreign Investment Promotion Act.

Minister of Knowledge Economy.[24] Free trade zones are divided into an industrial complex type and an airport/seaport type. Distribution center, cargo terminals, etc. can also be designated as FTZs. As of August 2009, seven complex-type FTZs, including Masan FTZ, and five port/airport-type FTZs have been designated. FTZs are regulated by the Act of Designation and Management of Free Trade Zones and the Enforcement Decree of this Act.

Free economic zones refer to the areas which aim to improve the management environment for foreign-capital invested enterprises and the living conditions for foreigners, and are designated by the Minister of Knowledge Economy.[25] FEZs provide various support measures for equipping infrastructures etc. such as high-tech industrial complexes and hinterlands to make it possible to conduct manufacturing, logistics, and tourism, and by furnishing pleasant living conditions that will attract high quality human resources from home and abroad. The Act on Designation and Management of Free Economic Zones and the Enforcement Decree of this Act allow establishment and operation of foreign education institutions, hospitals, foreign language service, foreign currency transactions, broadcasting, tax reductions, and fund support. As of August 2009, six areas have been designated as FEZs.

Since the Navoi FIEZ closely resembles the FTZ-type free zones in Korea, the following sections will discuss the main contents of the legal regime provided for under the Act of Designation and Management of Free Trade Zones and the corresponding Enforcement Decree.

3.3.1. Entry Requirements

The Act of Designation and Management of Free Trade Zones provides that the following categories of investors are eligible for locating in an FTZ, notably:[26]

- Domestic and foreign-capital invested manufacturing companies mainly for export purposes;
- Companies in wholesale mainly for import and export trades;
- Companies in logistics businesses such as warehousing, exhibitions, loading, transportation etc.; and
- Companies assisting located companies with financial support, customs clearance brokerage, insurance, accounting business and other services.

The first three categories are referred to in legislation as "located enterprise," while companies in the last category are qualified as "support enterprise." Any applicant company must obtain a location permit from the administrative authority of FTZs, i.e. the Minister of Knowledge Economy for industrial-complex FTZs and the Minister of Land, Transport and Maritime Affairs for airport/seaport FTZs. As a matter of priority, the administrative authority

24. Articles 2.1 and 4 of the Act on Designation and Management of Free Trade Zones.
25. Articles 2.1 and 4 of the Act on Designation and Management of Free Economic Zones.
26. Article 10 of the Act on Designation and Management of Free Trade Zones.

of FTZs may grant the location permit to foreign-capital invested enterprises, companies running a business using high technology or export-oriented enterprises. The following applicants are not eligible for obtaining location permits: (1) a(quasi-)incompetent person, (2) a person who has not yet reinstated after having been declared bankrupt, (3) certain imprisoned persons, (4) delinquent tax(customs duty) payers, (5) corporations that employ persons falling under the above-mentioned categories as an officer in charge of managing or overseeing the business of this corporation in the FTZ, and (6) persons with previous location permits being revoked two or less years ago.[27)]

The administrative authority of FTZs may revoke location permits if a located enterprise obtains the location permit illegally or loses its location qualification. The grounds for revocation of the location permit include, inter alia, running a business other than that for which the permit was granted, failure to meet the terms of the location permit or basic requirements for purchase or lease of land or factories, and termination or suspension of business for three months without any justifiable grounds.[28)]

3.3.2. Purchase/Lease of Land and Factories

Basic Requirements

Once a person obtains a location permit, it is required to conclude a sale and purchase contract or a lease contract covering the land, factory, building, and other facilities in the relevant FTZ within maximum 3 months from the date of issuing the location permit. In case of renting a state-owned factory or a factory owned by a local government, the person concerned is required to complete necessary installations within maximum 6 months from the conclusion of a lease contract. Such person must also obtain a construction permit or complete a constructions report. The precise periods for each of these actions are prescribed by ordinances of the Ministry of Knowledge Economy.[29)]

It is the administrative authority of FTZs who can sell or rent state-owned land or factories in FTZs. The rents and prices are determined by the administrative authority in consultation with the Minister of Strategy and Finance. The head of any local government may also rent or sell the land or factory that is owned by the local government(hereinafter "public-owned" land or factory) and located in the FTZ. The rental period for state-owned or public-owned land or factories may be up to 50 years.[30)]

The Act of Designation and Management of Free Trade Zones provides for some exceptions from general rules of building factories that are contained in the Industrial Cluster Development

27. Articles 11-12 of the Act on Designation and Management of Free Trade Zones.
28. Article 15 of the Act on Designation and Management of Free Trade Zones and the corresponding Ordinance of the Ministry of Knowledge Economy.
29. Article 13 of the Act on Designation and Management of Free Trade Zones.
30. Articles 17-18 of the Act on Designation and Management of Free Trade Zones.

and Factory Establishment Act(1990). For instance, as a general rule, a person, who intends to newly build or enlarge a factory or to alter the business type of the factory in the area of not less than 500 square meters must obtain the approval of the head of the local government Si/Gun/Gu(mayor or governor).[31] However, a person who obtained the location permit for entering the FTZ is already deemed to have obtained such an approval.[32]

The enterprise that rents state-owned land or public-owned land may construct factories and install permanent facilities on the land, provided that at the time when the rental term expires it will donate them to the state or reinstate such land back to the original condition.[33]

Payment of Purchase Price or Rents

In the event that state-owned land or factory in a FTZ is sold, but the purchaser is found to have trouble to pay the price in a lump sum(e.g. due to natural disasters or wars), the administrative authority of FTZs may extend the payment settlement date within the scope of 6 months or allow the purchaser to pay the price in installments, with certain interest specified by law for each respective case. For public-owned land or factory, the deferred or installment payment of the purchase price is determined by a relevant municipal ordinance.[34]

The administrative authority of FTZs or the head of the relevant local government may reduce or exempt rents, providing larger reductions for foreign-capital invested enterprises whose business involves high technology that is critical to increase international competitiveness of domestic industry.[35] For instance, located enterprises in the Masan FTZ are charged low rents for using private factory sites or standard factories, but the following enterprises are offered a 10-year rental exemption(extensible): (1) enterprises with new foreign investment exceeding USD 10 million(for rent of factory sites) or USD 5 million(for rent of standard factories); and (2) enterprises with high-level technology and new foreign investment exceeding USD 1 million.[36]

In the event that any located enterprise that has rented any land or factory fails to pay rents by the due date, the administrative authority of FTZs serves a notice demanding the payment of such overdue rent after setting a deadline of maximum 90 days. Should this enterprise again fail to pay such overdue rent by the deadline, the administrative authority may terminate the lease agreement or collect such overdue rent in the same manner of action taken to collect national or local tax in arrears.[37]

31. Article 13 of the Industrial Cluster Development and Factory Establishment Act.
32. Article 14 of the Act on Designation and Management of Free Trade Zones.
33. Article 22 of the Act on Designation and Management of Free Trade Zones.
34. Article 19 of the Act on Designation and Management of Free Trade Zones and Article 12 of the Enforcement Decree of the Act on Designation and Management of Free Trade Zones.
35. Article 20 of the Act on Designation and Management of Free Trade Zones.
36. Masan Free Trade Zone, <http://www.ftz.go.kr/eng/investment/rent.jsp> (visited 1 January 2010).
37. Article 21 of the Act on Designation and Management of Free Trade Zones and Article 13 of the Enforcement Decree of the Act on Designation and Management of Free Trade Zones.

Restrictions on Rental and Transfer of Factory

If a located enterprise constructs a factory or other facilities, using foreign goods, this enterprise is prohibited from renting or transferring the factory/facilities to any person other than located enterprises within 3 years from the date on which the factory etc. is fully constructed. Nevertheless, it may rent part of the factory etc. to any support enterprise after obtaining permission from the head of a customshouse.[38)]

Restrictions on Disposal of Land or Factory

When a located enterprise intends to dispose of any of state-owned or public-owned land, factories or other facilities that are acquired before the construction of the factory, building, or other facilities is completed, it must transfer such land, factory, etc. to the administrative authority of FTZs. If the administrative authority finds it difficult to accept such land or factory, it may have the land or factory transferred to another located enterprise or any other person that is qualified to be located in the FTZ. The transfer price of the land is the purchase price plus the relevant interest and cost, and the transfer price of the factory is the market price appraised by an appraisal and evaluation business operator. When a located company transfers or rents, or allows any other person to use the factory or other facilities that are constructed on the land owned by the state or any local government, it must report thereon to the administrative authority.[39)]

Use of Land/Factory by Third Persons

Third persons may acquire land or factories in the FTZ by auction or other means prescribed by legislation. In this case, in order to use them the third person is required to obtain a location permit, except for cases involving merger or acquisition of a located enterprise by a person who is qualified to be located in the FTZ. Should this person fail to obtain the location permit, he must transfer his land or factory to other located enterprises or any other third party who is admitted to be in the FTZ. If such transfer has not occurred, he is required to transfer the property in question to the administrative authority of FTZs.[40)]

3.3.3. Customs Procedures

Admission of Goods

In case of shipment of goods into an FTZ, a person concerned must make a shipment report to the head of the customshouse. With respect to the shipment of imported goods, the report comprises the following matters: (1) the name, standard, quantity, price and item classification number of the product; (2) the kind, number and article number of the packaging; (3) the destination, the country of origin and the country of loading; (4) the business operator

38. Article 24 of the Act on Designation and Management of Free Trade Zones.
39. Article 25 of the Act on Designation and Management of Free Trade Zones.
40. Article 26 of the Act on Designation and Management of Free Trade Zones.

registration number and customs clearance code; and (5) the material concerning a foreign trade ship/aircraft in the event of supplies used by such ship or aircraft.[41] In addition to the shipment report, the relevant person is also required to file an import declaration and pay customs duties. This rule does not, however, apply to located enterprises importing (a) machinery, instruments, installations, equipment and their parts; (b) raw materials, lubricants, office computers and construction materials; and (c) other products that are recognized by the Commissioner of the Korea Customs Service as being necessary to achieve business objectives.[42]

Located enterprises intending to use domestic goods as raw materials in the FTZ need to obtain approval from the head of customshouse. For this purpose, the enterprise files an application identifying the name, standard, quantity, weight and price of domestic goods and goods it intends to produce using such domestic goods, as well as the work period and the required quantity of domestic goods.[43]

Certain products are prohibited from entering the FTZ, including e.g. books or periodicals, audio-visual materials, paintings etc that threaten constitutional order or national security, as well as products containing state secrets or counterfeit currencies. The head of the customshouse may also restrict the shipment of goods that harm people's health and environment, illegal weapons, narcotics and others.[44]

Shipment of Goods out of FTZs

As a general rule, any person in the FTZ who aims to ship foreign goods out of Korea must make a report to the head of the customshouse thereon. In case of shipment of non-foreign goods, filing of an export declaration is required.[45] With respect to foreign goods that were once shipped into an FTZ, a located enterprise is allowed to temporarily ship it into the rest of the territory of Korea(hereinafter the "customs territory") for the purposes of repairing them, exhibiting them as sample goods, testing or inspecting them, provided that this enterprise obtains permission from the head of the customshouse. The period during which such shipment is permitted is limited to 6 months at most, though extensions for the reasons of inevitability are possible.[46]

If foreign goods are to be shipped from the FTZ to the customs territory in their original form or as incorporated into a new product, the relevant enterprise has to file an import

41. Article 19 of the Enforcement Decree of the Act on Designation and Management of Free Trade Zones.
42. Article 29(3) of the Act on Designation and Management of Free Trade Zones.
43. Article 30 of the Enforcement Decree of the Act on Designation and Management of Free Trade Zones.
44. Article 41 of the Act on Designation and Management of Free Trade Zones, and Article 29 of the Enforcement Decree of the Act on Designation and Management of Free Trade Zones.
45. Article 30 of the Act on Designation and Management of Free Trade Zones.
46. Article 33 of the Act on Designation and Management of Free Trade Zones and Article 23 of the Enforcement Decree of the Act on Designation and Management of Free Trade Zones.

declaration and pay customs duties.[47] In case of the new product with both domestic products used as raw materials and foreign inputs, the quantity or price of the relevant domestic inputs will be deducted from the customs duty base, provided that the use of domestic products was properly approved by the head of the customshouse.[48] Such deduction will be done based on the date on which the relevant domestic goods have been shipped into the FTZ or the date of issuance of a written domestic good confirmation.[49]

If domestic goods are to be moved from FTZs to the customs territory, the enterprise concerned submits to the head of the customshouse a written domestic goods confirmation, a tax invoice, and a document verifying the fact that they have been shipped into the FTZ as domestic goods. However, this is not required for accessible vehicles or articles carried by accessible persons.[50] Goods shipped into or out of the FTZ may be inspected by the head of the customshouse.[51]

Outward Work[52]

The Korean customs rules allow, under certain conditions, outward processing or repairing. Notably, if a located enterprise wishes to ship foreign goods into the customs territory to have them processed or repaired, this company should report to the head of the customshouse on the scope of such outward work, the shipment period, the goods to be shipped, and the shipment destination. Once the head of the customshouse receives the properly written outward work report, he or she accepts it without delay. It should be noted that the shipment for outward work purposes may be done either from the FTZ to the customs territory or directly from abroad to the customs territory of Korea. This implies that goods may undergo outward work either before or after entering the FTZ.

The scope of permissible outward work is generally calculated with reference to the amount (value) of goods that the relevant FTZ enterprise exported in the previous year after having processed them using raw materials. However, the law also envisages exceptional rules for outward processing in cases where there was no export performance for the previous year or the export performance disproportionately increased or decreased so that it would be inappropriate to use the export amount of the previous year as a benchmark. For all these cases, the scope of the outward work is defined as shown in Table 4-3.

47. Article 29(4) of the Act on Designation and Management of Free Trade Zones.
48. Article 44 of the Act on Designation and Management of Free Trade Zones.
49. Article 30(5) of the Enforcement Decree of the Act on Designation and Management of Free Trade Zones.
50. Article 31 of the Act on Designation and Management of Free Trade Zones.
51. Article 42 of the Act on Designation and Management of Free Trade Zones.
52. Article 34 of the Act on Designation and Management of Free Trade Zones and Article 24 of the Enforcement Decree of the Act on Designation and Management of Free Trade Zones.

Table 4-3 | Determination of the Scope of Outward Work

Condition	Scope of Outward Work
Export performance for the previous year	*Not more than 60/100 of the amount of the processed goods that the enterprise exported in the previous year*
No export performance for the previous year exists because of the start of business in the current year	*Not more than 60/100 of the annual export performance amount, i.e.,:* • Annual amount = the month with the highest export performance amount * 12 • This month is chosen from the period between the date of the start of business and the date of shipment report
	Not more than 60/100 of the annual export performance amount for cases where an export order is received for the first time after the business start: Annual amount = the amount of goods covered by the export order * 12
The amount of goods on which an export order is given in the month, during which a shipment report is made, increases by 150/100 or more from the monthly average export amount of the previous year.	*Not more than 60/100 of the annual export performance amount, i.e.,:* Annual amount = the amount of goods covered by an export order during the month of shipment report * 12
The export performance of the previous year fell to less than 50/100 because of natural disaster or other inevitability	*Not more than 60/100 of the annual export performance amount, i.e.,:* Annual amount = the amount of goods in the past year from the immediately preceding month during which the relevant grounds accrue

Source : Drawn up by the author.

Only two categories of goods are allowed to undergo outward work. These are (1) raw materials or (2) construction materials(including metal mold) that are exclusively used to manufacture and process raw materials. The shipment place for the outward work is limited to a factory operated by an enterprise conducting outward work, or a workshop attached to such enterprise.

The allowed period for the outward work on raw materials is limited to one year. With respect to construction materials, this period is confined to the period of the contract concluded between the FTZ enterprise and the enterprise entrusted with the outward works, but it cannot exceed three years. In the latter case, the customshouse' s head may extend the shipment period due to inevitable reasons(e.g. the outward work is not completed within the contract period) within the scope of three years.

If the goods from the FTZ undergo outward processing or repairing and are then moved from the outward work place to the rest of the customs territory, the relevant FTZ-located enterprise must file an import declaration and pay customs duties. If such goods are shipped from the outward work place directly to a foreign country, the enterprise must make a report to the head of the customshouse thereon. Such reporting is also required for situations where the located enterprise intends to dispose of waste articles arising from the outward work.[53)]

Inventory Management[54)]

Every located enterprise are generally obliged to record the names, standards, quantities and prices of (1) goods that are shipped into the FTZ, (2) goods that are used, consumed or produced in the FTZ and (3) goods that are shipped out of the FTZ. Separate inventory record and management is required for domestic raw materials, equipment, machinery etc. Inventory records must be kept for five years. The head of the customshouse is to be reported on foreign goods destroyed, lost or disposed of.

The head of the customshouse may require public officials of that customshouse to check whether located enterprises properly manage their inventory. In checking the inventory management, this official must produce his ID card evidencing his authority to persons concerned. Any located enterprise must submit, upon request of the head of the customshouse, its accounting book, its management ledger concerning raw materials and manufactured goods, and other materials which are necessary for checking the inventory management. Should the inventory of foreign goods be found to fall short as a result of the check, the head of the customshouse has to collect without delay the customs duties of such shortfall from the relevant enterprise, except cases involving e.g. goods destroyed due to disaster or other inevitability.

Disposal of Goods[55)]

With respect to goods that are expected to harm human life and property, rotten goods or goods with expired use-by date, the head of the customshouse may order their owner to ship such goods out of the territory of Korea or dispose of them. The cost incurred by shipment or disposal is borne by the owner of the good.

Customs and Tax Incentives

Tax incentives for FDIs were mainly provided for under the Foreign Investment Promotion Law. In 1999, the FDI tax incentive provisions were included into the Special Tax Treatment Control Law(1999). Under the latter law and the corresponding Enforcement Decree, FDIs entering FTZs or FEZs can benefit from several tax and customs exemptions, as demonstrated in Table 4-4.

53. Article 35 of the Act on Designation and Management of Free Trade Zones.
54. Articles 38-39 of the Act on Designation and Management of Free Trade Zones, and Article 26 of the Enforcement Decree of the Act on Designation and Management of Free Trade Zones.
55. Article 40 of the Act on Designation and Management of Free Trade Zones.

Table 4-4 | Customs and Tax Incentives for FTZ/FEZ Located Enterprises

Period of Application	Individual and corporate income taxes	Full exemption for 3 years, 50% reduction for next 2 years
	Local taxes: acquisition, property, registration	Full exemption for 3 years, 50% reduction for next 2 years (local governments can extend the period up to 15 years)
	Customs duties	Full exemption for 3 years on imported capital goods by foreign-capital invested companies
Conditions for Application	Manufacturing business	$ 10 million or more
	Tourism business	$ 10 million or more
	Logistics business	$ 5 million or more

Source : Korea National Tax Service, Korean Taxation 2008

The following foreign products are exempt from customs duties:[56)]

- Materials used by a located enterprise for constructing buildings and factories in the FTZ;
- Machinery, instruments, installations, equipment and their parts;
- Raw materials, lubricants, and office computers;
- Other goods recognized by the Commissioner of the Korea Customs Service as being necessary to achieve business objectives.

For all other foreign goods, the located enterprise needs to file an import declaration and pay customs duties. Domestic goods, for which a located enterprise makes a report on the shipment thereof into the FTZ, are deemed exported, and customs duties are exempted or refunded. They are subject to a zero-rate value-added tax. The zero-rate value-added tax also applies to foreign goods and services supplied between located enterprises.[57)]

4. International Rules on FEZs

4.1. Revised Kyoto Convention

The International Convention on the Simplification and Harmonization of Customs Procedures(Kyoto Convention) entered into force in 1974 and was revised by the Council of the World Customs Organization in June 1999 as the blueprint for modern and efficient customs procedures. The Revised Kyoto Convention elaborates several key governing principles, such as

56. Articles 29(3) of the Act on Designation and Management of Free Trade Zones.
57. Article 45 of the Act on Designation and Management of Free Trade Zones.

transparency and predictability of customs actions, standardization and simplification of the goods declaration and supporting documents, simplified procedures for authorized persons, maximum use of information technology, minimum necessary customs control to ensure compliance with regulations, use of risk management and audit based controls, coordinated interventions with other border agencies, and partnership with trade. The Revised Kyoto Convention entered into force on 3 February 2006 and has 64 contracting parties as of 3 August 2009.

The rules on customs affairs are contained in the General Annex and a number of Specific Annexes. Chapter 2 of Annex D specifically deals with FEZ-related issues. The Revised Kyoto Convention uses the term "free zone" which refers to "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." The Convention sets forth 21 standards and recommendations grouped in 10 main categories, as summarized below.

Establishment and Control: National legislation must specify requirements for the establishment of free zones, admissible goods and authorized operations, as well as customs control including appropriate requirements for the suitability, construction and layout of free zones. Moreover customs authorities should be free to check the goods stored in a free zone.

Admission of Goods: Not only imported but also domestic goods must be authorized to be admitted to the free zone. It is recommended that restriction of admission of imported goods be based only on public morality/security/health and veterinary or phytosanitary concerns, or for the sake of Intellectual Property(IP) protection. Admissible goods entitled to duty/tax exemption or repayment when exported must qualify for this immediately after they have been introduced into the free zone.

Security: It is recommended that no security for the admission of goods to a free zone be required.

Authorized Operations: Operations for preservation of goods(e.g., breaking bulk, grouping of packages, sorting and grading, and repacking) must be allowed. Rules on processing or manufacturing operations(if any) must also be specified.

Goods Consumed within the Free Zone: National legislation must lay down requirements for and enumerate the cases in which goods to be consumed inside the free zone may be admitted free of duties and taxes.

Duration of Stay of goods in a free zone must be set forth only in exceptional circumstances.

Transfer of Ownership of goods admitted to a free zone must be allowed.

Removal of Goods: Goods admitted to or produced in a free zone must be permitted to be removed to another free zone or placed under an applicable customs procedure. The only declaration required for goods on removal from a free zone must be the goods declaration normally required for the customs procedure to which those goods are assigned.

Assessment of Duties and Taxes: National legislation must specify the point in time for the purpose of determining the value and quantity of goods which may be taken into home use on removal from a free zone and the rates of the customs duties and taxes applicable to them. Moreover, the legislation must specify the rules for determining the amount of the customs duties and taxes chargeable on goods taken into home use after processing or manufacturing in a free zone.

Closure of a Free Zone: In case of the closure of a free zone, the persons concerned shall be given sufficient time to remove their goods to another free zone or to place them under a customs procedure concerned.

4.2. WTO Disciplines

The World Trade Organization(WTO) is an international organization governing the multilateral trading system. Officially, it was established on 1 January 1995 as a successor to the General Agreement on Tariffs and Trade(GATT). With its membership of 153 countries(as of 1 January 2010), the WTO accounts for almost 96% of world trade and is thus very close to become a truly universal body. A further 29 countries including Uzbekistan have applied for WTO membership. As seen from Table 4-5, Uzbekistan applied on 8 December 1994. The Working Party established on 24 December 1994 has held three meetings so far.

The WTO sets forth very comprehensive and complicated rules that regulate trade on a global level. One hundred and two WTO members operate FEZs.[58] Although no specific provision in the WTO legal package deals with FEZs as such, some of its disciplines still have certain implications for FEZs. Indeed, WTO members are required to notify their laws and regulation relating to FEZs.[59] Since FEZs provide for a variety of customs or tax incentives, the products made there become more price competitive in foreign markets. This may give rise to concerns, on the part of foreign producers, that such competitiveness is unjustified and unfair in light of international trade rules. Thus, it is incumbent upon the country concerned to ensure that such incentives are fully consistent with applicable international standards. Indeed, virtually all working party reports and protocols of accession contain a separate section on the respective country's FEZ-policy which indicates the importance of this issue in the WTO context. In particular, the main elements of protocol commitments are as follows:

58. See Annex 1 of this Chapter.
59. See "Indicative List of Notifiable Measures" attached to the Uruguay Round Ministerial Decision on Notification Procedures(15 December 1993).

Table 4-5 | Uzbekistan's WTO Accession Status

1	Application Received	8 December 1994
2	Working Party Established	21 December 1994.
3	Memorandum	21, 26 and 27 October 1998.
4	Questions and Replies	12 October 1999 27 April 2000 19 January 2001
5	Meetings of the Working Party	17 July 2002 29 June 2004 14 October 2005
6	Recently submitted documentation	
	(a) Additional Questions & Replies	2 August 2006
	(b) Information on agriculture	1 June 2004 21 September 2005
	(c) Information on services	
	(d) SPS/TBT checklists	2 June 2005 (TBT) 2 June 2005 (SPS)
	(e) TRIPS checklist	7 October 2005
	(f) Legislative Action Plan	27 March 2007
7	Market Access Negotiations	
	Goods Offer (a) initial (b) latest	2 September 2005
	Services Offer (a) initial (b) latest	7 September 2005
8	Factual Summary	
9	Draft Working Party Report	

Source : WTO, (http://www.wto.org/english/thewto_e/acc_e/a1_ouzbekistan_e.htm)

"The representative of [X] stated that [X] would administer free zones or special economic areas established in its territory in compliance with WTO provisions, including those addressing subsidies, TRIMs and TRIPS, and that goods produced within the zones under tax and tariff provisions that exempt imports and imported inputs from tariffs and certain taxes would be subject to normal customs formalities when entering the rest of [X], including the application of tariffs and any taxes and charges."[60]

Some acceding governments assure that incentives provided to foreign enterprises in its

60. Peter John Williams, A Handbook on Accession to the WTO, Cambridge: Cambridge University Press, 2008, p. 100.

FEZs would apply on a non-discriminatory basis.[61] Accordingly, WTO Members may question the consistency of FEZs with WTO rules on (1) non-discrimination, (2) subsidy, (3) trade-related investment measures (TRIMs) and (4) trade-related intellectual property rights (TRIPS). Each of these issues will be examined below.

4.2.1. Non-Discrimination

Non-discrimination is a very important pillar of the multilateral trading system. Two principles of non-discrimination - most favored nation(MFN) treatment and national treatment - are set forth in the General Agreement on Tariffs and Trade(GATT), the General Agreement on Trade in Services(GATS) and the Agreement on Trade-related Aspects of Intellectual Property Rights(TRIPS). With respect to goods, the MFN principle requires that the products of all WTO Members be accorded equal treatment. National treatment prohibits discrimination against imported goods as compared to domestic goods. In the services sector, MFN and national treatment are accorded to services and service suppliers; in the TRIPS - to the nationals of Members.

Both MFN and national treatment apply not only in the country's customs territory but also in FEZs of that country. This means that the preferential legal regime within the FEZs must be applied without discrimination based on the origin of goods, services, service suppliers or IP owners.

4.2.2. Subsidy

Subsidies provided by a Member's government to domestic producers may have trade distorting effect, and are thus regulated in the WTO. According to Article 1.1 of the WTO Agreement on Subsidies and Countervailing Measures(SCM Agreement), a subsidy has two elements: (1) a financial contribution(direct transfer of funds, tax credits, goods or services other than general infrastructure etc.) by a government or other public body, and (2) a benefit conferred thereby. The SCM Agreement distinguishes prohibited(export or import substitution) subsides and actionable subsidies. The WTO rules on non-actionable or "green-light" subsidies are no more applicable.

The SCM Agreement explicitly permits exemption or remission(reduction or refund) of customs duties or indirect taxes(e.g., value-added tax) borne by an exported product.[62] Accordingly, duty drawback schemes provided for products manufactured in FEZs and exported abroad are not considered as a subsidy and are thus fully in compliance with WTO rules. Likewise, the provision by the government of general infrastructure to enterprises inside SEZs

61. See e.g. WTO, Report of the Working Party on the Accession of China, WT/MIN(01)/3 (10 November 2001), para. 228.
62. See footnote 1 of the SCM Agreement, GATT Article XVI (Note to Article XVI) and Annexes I-III of the SCM Agreement.

is not prohibited in the WTO.[63] Furthermore, any financial contribution(provision of equity capital, loans, loan guarantees etc.) by the government which does not confer a benefit can be justified as it does not constitute a subsidy.[64] At the same time, Annex I of the SCM Agreement provides for an indicative list of export subsidies which should be avoided in FEZs. Import substitution subsidies should not be provided in FEZs either. One of the practical ways to do this is providing incentives to FEZ-located enterprises which are not contingent(conditional) upon their export performance or import substitution.[65]

4.2.3. TRIMs

Article 2 of the TRIMs Agreement requires Members that they do not apply any TRIM that violates Article III(national treatment) or Article XI(general prohibition of quantitative restrictions) of the GATT. Specifically, the eligibility of benefits for companies locating in a FEZ should not be contingent upon the use of domestic over imported goods. Such local content requirement is recognized as a WTO-inconsistent TRIM.[66] For this reason, the Former Yugoslav Republic of Macedonia assured the WTO membership that it would not provide local-content incentives to enterprises working in its FEZs.[67]

4.2.4. TRIPS

The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights(TRIPS) provides a legal framework for IP protection in the context of international trade. Notably, the agreement covers five broad issues: (1) application of basic principles of the trading system and other international IP agreements, (2) adequate protection to IP rights, (3) enforcement of IP rights in the member's territory, (4) dispute settlement on IP between WTO members, and (5) special transitional arrangements during the period when the new system is being introduced. Since a FEZ is a part of the country's territory, the country concerned has to observe and fully enforce its TRIPS commitments in its FEZs.

4.3. Regional Trade Agreements

Regional trade agreements(RTAs) complement the multilateral trading system of the WTO through intensifying trade liberalization at regional and bilateral levels. RTAs take the form of either a free trade agreement(FTA) or a customs union. The FTA eliminates customs duties and

63. Article 1.1(a)(1)(iii) of the SCM Agreement.
64. See Article 14 of the SCM Agreement.
65. See e.g. WTO, Report of the Working Party on the Accession of Viet Nam, WT/ACC/VNM/48 (27 October 2006), paras. 285 and 288.
66. See Annex of the TRIMs Agreement("Illustrative List").
67. WTO, Report of the Working Party on the Accession of the Former Yugoslav Republic of Macedonia, WT/ACC/807/27 (26 September 2002), para. 154.

other restrictive regulations of commerce with respect to substantially all the trade between its contracting parties. The customs union also removes internal trade barriers, but unlike FTA introduces a common external tariff vis-a-vis third countries. Expanding proliferation of RTAs is a current trend in global trade. Some 421 RTAs have been notified to the GATT/WTO up to December 2008, with 230 agreements being in force.[68]

Uzbekistan signed both the multilateral CIS FTA of 15 April 1994, and bilateral FTAs with most of the CIS countries.[69] Thus, Uzbekistan enjoys duty free access to the goods market of eleven countries(including Georgia) in the CIS region. Unlike some RTAs(e.g., MERCOSUR, NAFTA or EU-Chile FTA), Uzbekistan's FTAs do not seem to impose any specific restrictions on trade in FEZ-made goods. Namely, preferential treatment under the Uzbekistan's FTAs would apply to all eligible goods irrespective of whether they are produced in an FEZ or the rest of the territory of contracting parties. This makes the CIS market the most attractive export destination for goods manufactured in the Navoi FIEZ.

5. Conclusion: Implications and Recommendations for the Navoi FIEZ

On the basis of the analysis above, this section provides some tailor-made recommendations for improvement of the Uzbek legislation. While admitting that laws and regulations related to investments should be as perfect as possible, the work on improvement of national legislation itself may not always suffice to meet investors' needs. According to worldwide practice, investors are also very much interested in the way the law is applied in practice. In this respect, the proper implementation and enforcement of laws, their strict observance by authorities are other noteworthy factors whose importance should not be underestimated in conducting investment policies. Thus, it is suggested that the Uzbek government regularly survey Navoi FIEZ companies in order to identify gaps in both legislation and practice, and take necessary measures to improve the investment climate.

5.1. Uzbek Legislation's Perspective

Resolution No. 105(Annex 3) requires that investment agreements cover several issues including the amount and object of investments, activities; period and conditions of application of the agreement; the rights and obligations of the parties; parties' liability; dispute settlement

68. WTO, "Regional Trade Agreements", <http://www.wto.org/english/tratop_e/region_e/region_e.htm>(visited 1 November 2009).
69. For trade integration in the CIS region, see e.g. Sherzod Shadikhodjaev, "Trade Integration in the CIS Region: A Thorny Path Towards a Customs Union", Journal of International Economic Law, Oxford University Press, Vol. 12, No. 3 (2009), pp. 555-578.

and many others. According to this Resolution, it is the investor who must present the draft of an investment agreement to the FIEZ Directorate. The draft is then to be reviewed by the Directorate within ten days. If necessary, negotiations between the parties may take place, and the Directorate may request advice from a competent body. This procedure seems to grant a lot of discretion to the investor. Nevertheless, in order to facilitate the "agreement-making" process, the Directorate could work out, in advance, a number of non-binding sample(model) agreements in collaboration with the competent state bodies and prominent law firms(possibly from abroad). These sample agreements could provide some ground for the investor in formulating its own draft agreement. This is especially important in light of the fact that the majority of investors interested in the FIEZ would come from abroad, and they would not be aware of all specificities of the Uzbek legal system. Moreover, sample agreements would reduce time and costs related to the preparation of investment agreements.

Some improvement could also be implemented with respect to employment of foreigners in the Navoi FIEZ. For instance, the current rules for recruiting foreign employees in both the Navoi FIEZ and the rest of Uzbekistan allow issuing work permits for up to one year with possible extension. In this respect, it is suggested that work permits be given for more than one year at least for those foreign specialists whose expertise is especially needed in effective operation of enterprises in the zone. For instance, given that the Navoi FIEZ intends to attract high technology production, it is suggested that foreign engineers or other know-how holders be offered longer work permits. Longer work permits could also be given to foreign investors(natural persons) themselves who aim to run their business in the zone. This could ensure, to certain extent, long-term interests of foreign investors in the Navoi FIEZ.

Article 22 of the Foreign Investment Law and Article 12 of the Foreign Investment Protection Law set forth that in the event of a conflict between the respective Law and other legislative acts or treaties, the provisions most favourable to foreign investors would prevail. It is suggested that the same conflict resolution clause be included in the FEZ legislation. Moreover, since not only foreign investments but also domestic investments may be accumulated in the Navoi FIEZ, it is also suggested that the existing foreign investment protection guarantees apply, mutatis mutandis, to domestic investments. For instance, prevention of "injurious" law, ownership guarantees, favourable resolution of rule conflicts and other relevant guaranties could be offered to domestic investors.

Article 3 of the FEZ Law stipulates that closure of an FEZ is possible in only two cases: expiry of the FEZ operation period, or failure to accomplish the purposes or tasks imposed on the FEZ concerned. At the same time, paragraph 33 of Annex 1 to Resolution No. 21 states that the Navoi FIEZ may also be closed for national security reasons - something which is not foreseen in the FEZ law. It is recommended that this discrepancy be removed by inclusion of the national security clause in the FEZ law, or else the provision of the government resolution in question will be null due to the Law's superiority recognized in the Uzbek normative hierarchy.

In this respect, it is desirable to clarify the national security clause by giving some examples that would fall within its scope (e.g., national defence; protection of environment, human life/health or cultural heritage; etc.). In addition, it is not clear what is to be understood by failure to accomplish the purposes or tasks imposed on the FEZ - another reason which can lead to the FEZ closure. Is such failure assessment done on the basis of the number of projects, investment agreements, the FDI volume or any other criteria? Certainly, the clarification of this point would be another source for improvement.

The exemption of Navoi FIEZ enterprises from the general requirement under Cabinet of Ministers' Resolution No. 245(29 June 2000) to sell to authorized banks 50% of the foreign-exchange proceeds obtained through de-centralized exports would certainly increase the investment attractiveness of the zone.

Finally, in a KDI-performed survey of the Korean businessmen who visited the Navoi FIEZ in June-July 2009, some respondents indicated the lack of detailed information on Uzbekistan's investment environment. Accordingly, the Uzbek government should take more efforts to keep foreign investors informed of the current state of play and investment opportunities, and its domestic law. It is acknowledged that the annual Investment Guide to Uzbekistan prepared in English by the UNDP in collaboration with the Uzbek government is an important project in this direction. Nevertheless, this publication could be supplemented by e.g., a collection of Uzbek laws and government regulations, translated into English, on foreign investments, FEZs and other areas of interest to foreign investors(customs, taxation, labour rules, financial transactions, dispute resolution etc.). This collection could be accompanied with detailed commentaries on sector-specific rules and practice. As with Investment Guide to Uzbekistan, the collection should periodically be updated and posted on the Internet. In addition, Uzbekistan's embassies and other representative missions abroad could also play more active role in providing foreign investors with reliable information about business environment in Uzbekistan.

5.2. Korean Legislation's Perspective

Given that over 100 countries around the world have set up FEZs, their national legislations provide some useful starting points for designing and improving Uzbek rules on FEZs. In this respect, Korea can certainly serve as an appropriate benchmarking country. Indeed, it has 40-year experience of enormous legislative work on free zones. Moreover, it is a civil law country as Uzbekistan is. Even many similarities between Korea and Uzbekistan in culture and other social aspects may indicate similarities in people's perception of law. Finally, the fact that the majority of foreign investors registered in the Navoi FIEZ so far are Korean companies is another indicator in support of learning Korean legislation on foreign investment and free zones. Accordingly, Korea's rule-making experience in this field offers certain food for thought that may be taken into account by the Uzbek government. The following three implications are derived from Korea's current legislation, albeit with some reference to its first law on free zones.

First, various support measures for foreign investors such as financial grants, or special awards for attraction of FDI could be introduced in Uzbekistan. A grievance settlement mechanism by an ombudsman for foreign investment could be established either as an independent body or under UZINFOINVEST. This mechanism would not only help foreign investors experiencing some problems in adapting to local conditions, but also facilitate the interaction between foreign investors and relevant government agencies. The foreign investment ombudsman would identify daily-life difficulties faced by foreigners that would be taken into consideration by the government in its efforts to improve business environment in Uzbekistan in general and the Navoi FIEZ in particular.

Second, legal regimes for both FTZs and FEZs are set forth by separate "Acts" whose legal status in Korea corresponds to "Law" in Uzbekistan. Accordingly, procedural issues (designation and administration of a zone, location requirements for investors, handling of property issues, customs procedures and etc.) and basic incentives for investors(exemption and refund of customs duties and taxes, and etc.) are dealt with, in detail, in corresponding Acts, with certain aspects (concrete time-periods, numerical specifications and others) being specified in respective enforcement decrees and rules that correspond to Uzbek "sub-legislative acts." In other words, most aspects of FTZs and FEZs in Korea are covered by the respective Acts. Based on Korean experience, Uzbek legislators could also upgrade the regulatory level of the legal regime in the Navoi FIEZ from sub-legislative acts to the level of legislative acts. At the same time, it is acknowledged that some time for "testing" the existing sub-legislative acts would be required. Even if one looks at the historic development of legal regulation of free zones in Korea, one can observe that while the very first Korean Act on Establishment of Free Export Zones(1970) consisted of just 30 articles with general contents largely elaborated in subordinate regulations, the latest version (2009) of the Act of Designation and Management of Free Trade Zones alone contains 70 articles with very detailed provisions. Thus, with the passage of time the Uzbek legislators could also incorporate some of the existing sub-legislative provisions and include new ones into the FEZ Law or probably a new FIEZ Law.

Third, although the Uzbek legislation including both principal and supplementary disciplines on FEZs covers virtually all aspects of the Navoi FIEZ, the Korean Act of Designation and Management of Free Trade Zones may be used as a benchmark for elaborating on several issues that are indispensible for a smooth operation of the Navoi FIEZ. First of all, the existing customs procedure rules for the Navoi FIEZ could be specified in more detail with reference to corresponding provisions of the Act in question. For instance, outward processing disciplines would increase the industrial linkage between enterprises located in and out of the Navoi FIEZ securing more jobs and technology transfer in the region. As a matter of fact, the outsourcing of certain manufacturing processes has contributed to the success of the Masan FTZ.[70] It is noteworthy that the permissible scope of outward processing in Korea's FTZs is linked to the export performance of the located enterprise concerned. The more the enterprise exported in the previous year, the greater is the possible extent of outward processing in the current year. This linkage to export performance indirectly contributes to the expansion of export-oriented production. Another important point is that customs incentives for FTZs continue to apply to goods undergoing outward processing provided that they are not placed into the customs territory of Korea. In contrast, Uzbek legislation explicitly states that the special tax/customs/currency regime applies exclusively within the territory of the Navoi FIEZ.[71] Thus, this aspect could be improved accordingly. In addition, Uzbek legislators could also take into account Korean provisions dealing with investor's property, including ownership and transfer of factories in a free zone. In any event, there is a need to clarify the legal status of factories and other capital facilities built by investors in the Navoi FIEZ.

Finally, the cooperation between the authorities of the Navoi FIEZ and the Korean FTZs/FEZs based on a special memorandum of understanding or agreement would certainly contribute to knowledge sharing with respect to legal regulation and practical issues concerning free zones and foreign investments.

5.3. International Rules' Perspective

Although Uzbekistan has not yet acceded to the Revised Kyoto Convention, its provisions may give some guidance in designing national rules on FEZ and are thus worth considering. As this Convention is about customs administration, its FEZ-related provisions could be considered for designing or improving Uzbek rules on customs matters. For instance, under Standard 19 of the Revised Kyoto Convention, national legislation is required to specify the point in time to be considered when determining the rates of import duties or taxes for goods removed from a free zone into the customs territory. Between the time when the goods entered a free zone and the time when they are taken into home use, the national customs tariff or taxation may change. Two alternatives are thus possible. The duties/taxes concerned may be those that applied at the time of entry of the goods into the free zone, or apply at the time of delivery from the free zone. National legislation may also allow the located enterprise to choose between these options. Annex 1 of Resolution No. 120, notably paragraphs 13(especially on indirect taxes) and 15 seem to be silent on the point of time. This may potentially lead to arbitrary use of the existing requirements. It is thus recommended that the Navoi FIEZ legislation explicitly set the timing or offer the opportunity to the resident enterprise concerned to choose the duty/tax rate from the two available alternatives if the applicable rates at the time of entry and delivery of goods differ.

70. Interestingly, Article 13 of the 1970 Act on Establishment of Free Export Zones initially provided that goods introduced or imported into a free zone must have been kept or used in bond only within the free zone. However, just two years later after the adoption of this Act(i.e. in 1972), Korean legislators added a provision which allowed outward work. This certainly demonstrates the importance of this clause.

71. Paragraph 24 of Annex 1 to Resolution No. 21 and paragraph 3 of Annex 1 to Resolution No. 120.

With respect to WTO rules, there has not been any FEZ-related dispute in the WTO system. This suggests that WTO members have been reluctant in raising a formal complaint which would challenge FEZs in a particular country. Perhaps the reason is that many members have FEZs, and companies of many members are located in FEZs. Another reason could be that FEZs may share just a small part of external trade of the country concerned so that their impact on trade interests of other member counties would be marginal. On the other hand, acceding countries are usually questioned by the existing WTO members with respect to certain aspects of their FEZ policy. As long as Uzbekistan is not a WTO member, it is not bound by the WTO disciplines. But given possible accession to this organization in the future, the Uzbek negotiating team should be well-aware of the relevant multilateral trade rules so as to be better prepared for any claim which could be raised by WTO members in the course of Uzbekistan's accession talks.

RTAs are a very useful tool to secure duty-free trade flows. One of the encouraging points of Uzbekistan's RTAs is that they do not specifically restrict import or export of FEZ-made goods. Thus, it is suggested that the Uzbek government continue to follow this "non-restriction" approach in any potential RTA negotiations with other countries in the future.

At the same time, RTAs should not become a means through which goods produced in Uzbek FEZs could be shipped(imported) to the domestic market of Uzbekistan via another RTA country, *with no duties and taxes paid*. This certainly requires maximum vigilance from the Uzbek customs authority against such an arbitray use of RTAs.

Annex 1 Countries and Territories with Free Zones(as of 1 January 2010)

Country or Territory	Wide Area	Small Area	Industry Specific	Performance Specific
1. ALGERIA		□		
2. AMERICAN SAMOA		□		
3. ANGOLA		□		
4. ARGENTINA		□		
5. ARUBA		□		
6. AUSTRALIA		□		
7. AUSTRIA		□		
8. BAHAMAS		□		
9. BANGLADESH		□		
10. BELIZE		□		
11. BERMUDA			□	
12. BOLIVIA		□		
13. BRAZIL	□	□		
14. BULGARIA		□		
15. BURUNDI		□		

16. CAMEROON		☐		
17. CAPE VERDE		☐		
18. CAYMAN ISLANDS			☐	
19. CHILE		☐		
20. CHINA (MAINLAND)	☐	☐	☐	☐
21. COLOMBIA		☐		
22. COSTA RICA		☐		
23. CROATIA		☐		
24. CUBA		☐		
25. CURACAO, NETHERLANDS ANTILLES		☐		
26. CYPRUS		☐		
27. DENMARK		☐		
28. DJIBOUTI		☐		
29. DOMINICAN REPUBLIC		☐	☐	
30. ECUADOR		☐		
31. EGYPT		☐		
32. EL SALVADOR		☐		
33. FIJI		☐		
34. FINLAND		☐		
35. FRANCE		☐	☐	
36. GABON		☐		
37. GAZA STRIP ADMNSTD BY ISRAEL		☐		
38. GERMANY		☐	☐	
39. GHANA		☐		
40. GIBRALTAR		☐		
41. GREECE		☐		
42. GUADELOUPE		☐		
43. GUAM		☐		
44. GUATEMALA		☐		
45. HAITI		☐		
46. HONDURAS		☐		
47. HONG KONG	☐	☐	☐	
48. HUNGARY		☐		
49. ICELAND		☐		
50. INDIA	☐	☐	☐	☐
51. INDONESIA		☐		
52. IRAN		☐		
53. IRELAND		☐		
54. ISRAEL		☐		
55. ITALY		☐		
56. IVORY COAST		☐		

57. JAMAICA		☐		
58. JAPAN		☐	☐	
59. JORDAN		☐		
60. KAZAKHSTAN	☐			
61. KENYA		☐		
62. KOREA, REPUBLIC OF		☐		
63. KUWAIT		☐		
64. KYRGYZSTAN	☐			
65. LATVIA		☐		
66. LEBANON		☐		
67. LESOTHO		☐		
68. LIBERIA		☐		
69. LIBYA				
70. LIECHTENSTEIN	☐			
71. LITHUANIA		☐		
72. MACAO		☐		
73. MADAGASCAR		☐		
74. MALAWI		☐		
75. MALAYSIA		☐		
76. MALI		☐		
77. MALTA AND GOZO		☐		
78. MAURITIUS		☐		☐
79. MEXICO		☐		☐
80. MOLDOVA		☐		
81. MONACO	☐			
82. MONGOLIA		☐		
83. MOROCCO		☐		
84. MOZAMBIQUE		☐		
85. NAMIBIA		☐		
86. NEW ZEALAND		☐		
87. NICARAGUA		☐		
88. NIGERIA		☐		
89. NORTH KOREA		☐		
90. OMAN		☐		
91. PAKISTAN		☐		
92. PANAMA		☐	☐	
93. PERU		☐		
94. PHILIPPINES	☐	☐		
95. POLAND		☐		
96. PORTUGAL		☐		
97. PUERTO RICO		☐		

98. ROMANIA		☐		
99. RUSSIA	☐	☐		
100. SENEGAL		☐		
101. SERBIA		☐		
102. SEYCHELLES		☐		
103. SINGAPORE	☐	☐		
104. SLOVAKIA		☐		
105. SLOVENIA		☐		
106. SOUTH AFRICA		☐		
107. SPAIN		☐		
108. SRI LANKA	☐	☐		
109. ST. KITTS-NEVIS		☐		
110. ST. LUCIA		☐		
111. SUDAN		☐		
112. SWEDEN		☐		
113. SYRIAN ARAB REPUBLIC		☐		
114. TAIWAN		☐	☐	
115. TANZANIA		☐		
116. THAILAND		☐		
117. TOGO		☐		
118. TRINIDAD AND TOBAGO		☐	☐	
119. TUNISIA		☐		
120. TURKEY		☐		
121. UKRAINE		☐		
122. UNITED ARAB EMIRATES		☐		
123. UNITED KINGDOM		☐		
124. URUGUAY		☐		
125. USA		☐	☐	
126. UZBEKISTAN		☐		
127. VANUATU			☐	
128. VENEZUELA		☐		
129. VIETNAM		☐		
130. WEST BANK ADMNSTD BY ISRAEL		☐		
131. YEMEN		☐		
132. YUGOSLAVIA		☐		
133. ZIMBABWE		☐		

Source : Source: World Economic Processing Zones Association, (http://www.wepza.org)
Notes: * Uzbekistan is included by the author.
** Highlighted countries(territories) are WTO members as of 1 January 2010.
*** Definitions:

Wide area

Large zones with a resident population such as the Chinese Special Economic Zones or new cities.

Small area

Zones that are generally smaller than 1000 Ha. normally surrounded by a fence. Investors must locate within the zone to receive benefits. No resident population, although they may contain worker dormitories.

Industry Specific

Zones that are created to support the needs of a specific industry such as banking, jewelry, oil and gas, electronics, textiles, tourism, etc. Companies invested in the zone may be located anywhere and receive benefits. Examples include India's Jewelry Zones, or many offshore banking zones.

Performance Specific

Zones that admit only investors that meet certain performance criteria such as degree of exports, level of technology, size of investment, etc. Companies can be located anywhere. Examples include India's export oriented factories, the Mexico Maquila program, or a research park.

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