

## MAIN CHARACTERISTICS OF ECONOMIC ZONES TYPES: LATVIA'S EXPERIENCE

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**Abstract.** Promotion of entrepreneurship in each country nowadays is a key task for reducing regional disparities between regions. Economic zones are an instrument that can attract foreign investments, create new job places and influence business activities in general. Overall, the number of economic zones in the world is growing. The main benefit of operating in economic zone for entrepreneurs is state aid in the form of different tax exemption. There are more than few terms used that refer to economic zones, for example – special economic zone, free trade zone, freeport etc. By using descriptive methods, authors described main characteristics of economic zones' types and presented Latvia's experience about different economic zones. Results of research show that there are four basic types of economic zones and each type has its own specific characteristics. Usually term "special economic zone" is used to describe "economic zone" in general.

**Key words:** foreign investment; business tax; regional development; economic zone; free zone.

**JEL code:** F21; H32; R11

### Introduction

Regional differences in economic growth have been observed within many countries (Okabe et al., 2017) and regional disparities between different regions of the country is one of the most important aspects of regional policy nowadays, especially in Eastern European countries, including Latvia. In order to reduce the backwardness of the least favoured regions, it is necessary to use tools that can create an immediate and at the same time long-term improvements in the socio-economic situation. One of these instruments to reduce regional disparities is to establish economic zones.

Economic zone is considered as an effective method of promoting regional growth, which is evidenced by the fact that in recent years development of economic zones has been rapid, tendencies show that the number of economic zones still increase. Considering that economic zones develop expansively, one can distinguish several types of economic zones; the terms "special economic zone", "free economic zone", "freeport" etc. are used freely, without accentuating differences and thus creating conception that all above mentioned terms are with one and the same meaning. Authors pay attention to the lack of common criteria about different economic zones' types and unreasonable use of such terms.

The aim of the paper is to define main characteristics of economic zones types and to present Latvia's experience about different economic zones. To achieve the aim, the following tasks are set:

- 1) to describe importance of economic zones in process of decreasing regional disparities;
- 2) to define types of economic zones and main characteristics for their classification;
- 3) to analyse Latvia's experience about different economic zones.

The descriptive methods (analysis and synthesis) were used in the research; which novelty is proper exposition of main characteristics according to different types of economic zones and analysis of Latvia's case.

### Research results and discussion

#### 1. Importance of economic zones to reduce regional disparities

Although variety of terms is used to indicate economic zones, researchers link economic zones' existence and importance to regional development from ancient or antique times. Particular historical aspects about creation of economic zones were studied by Latvian researcher V.Rankevica (V.Rankevica, 2006), she elaborated classic model of economic zones' evolution and summarized the possible "free economic zone" concept formulation. Authors agree with above mentioned researcher's opinion

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regarding to historical definition of economic zones, but this article provides up-to-date view about significance of economic zones and characteristics of various term "economic zone". Many countries use free zones as regional development tools in remote areas where they perceive jobs to be particularly needed; economic zones are used as promotion of regional economic integration (Farole et al., 2011).

Nowadays, importance of economic zones in context with regional development is actual research topic; researchers highlight that special economic zones attempt to foster agglomeration economies, as for example attraction of industrial facilities (Wang, 2012). Significant contribution in the field of analysis about economic zone impact to regional development did researchers from India and China, which often evaluated benevolent return of economic zones in the context of regional development. Economic zones as a policy concept and tool were tested over long periods of time in aforementioned countries, which are the most visible examples (Liptak et al., 2015). Example of China (Shanghai free trade zone) shows that implementation of current economic zone will not only stimulate trade, but will also bring increased shipping opportunities to the city; with free trade as new direction and focus of the country's economic initiatives, current economic zone will lay the groundwork for a new round of reforms of Chinese economy (Wan et al., 2014). In many countries, economic zones are key policy instruments that attract foreign direct investment, boost exports and decrease unemployment (Ambroziak, 2016). The Organisation for Economic Co-operation and Development and the World Bank has carried out various studies about economic zones. As the World Bank's expertise says: "Any country that didn't have an SEZ ten years ago either does now or seems to be planning one" (The Economist, 2015).

Various economic zones, regardless of their type, associates organization named World

Economic Processing Zones Association, which carries out in-depth research about meaning of economic zones in context of regional development, as well.

## **2. Types of economic zones and main characteristics for their classification**

Nowadays, regarding to different types of economic zones, researchers and economists use term or concept "special economic zone", which usage is not always proper. The fact that concept "special economic zone" is used mostly in their studies was also indicated by the World Bank (Farole et al., 2011). Multiple variants of terminologies regarding to different economic zones are not always used consistently by different institutions and researchers (Farole et al., 2011). The economic zone concept continues to evolve and expand to include new terminology and functions. There are now "special economic zones", "free zones", "free trade zones", "foreign trade zones", "industrial development zones" and so on (Association of Special Economic Zones).

Researchers in the frame of academic and professional literature have tried to find an opportunity to develop a common approach to define types of economic zones, but still such efforts are not implemented. Researchers say that there are many types of geographically delimited areas offering certain incentives to businesses physically located within the zone (Ambroziak, 2016). Sometimes instead of term "special economic zone" there are used other terms "free trade zone" or "export processing zone", which are established with external trade in mind and aimed at the improvement of conditions for warehousing, storage and distribution facilities for trade, transshipment and export oriented operations (Ambroziak, 2016). Also term "free economic zones" is used freely, the term includes free ports, free trade zones, foreign-trade zones and export processing zones with relaxed laws or regulations that can attract investment and create employment (Chiu et al., 2011). However, there are also risks, one should

be very cautious in classifying free trade zone, because the original concept has evolved over time and has acquired a different meaning in different context (Ambroziak, 2016). Among risks, specific criteria or main characteristics for economic zone types are missing and mostly the definition is given for term "special economic zone". For example, special economic zones are defined as economic enclaves created by government in order to attract domestic and foreign investors, and to stimulate the economy growth and the regional development (Pastusiak et al., 2015).

Based on the assumptions of the Organisation for Economic Co-operation and Development (OECD, 2011), term "economic zone" can be divided into four main groups – free trade zone, special economic zone, investment zone, export processing zone. Characteristics and specific features for each of four groups are settled in following order in Figure 1:

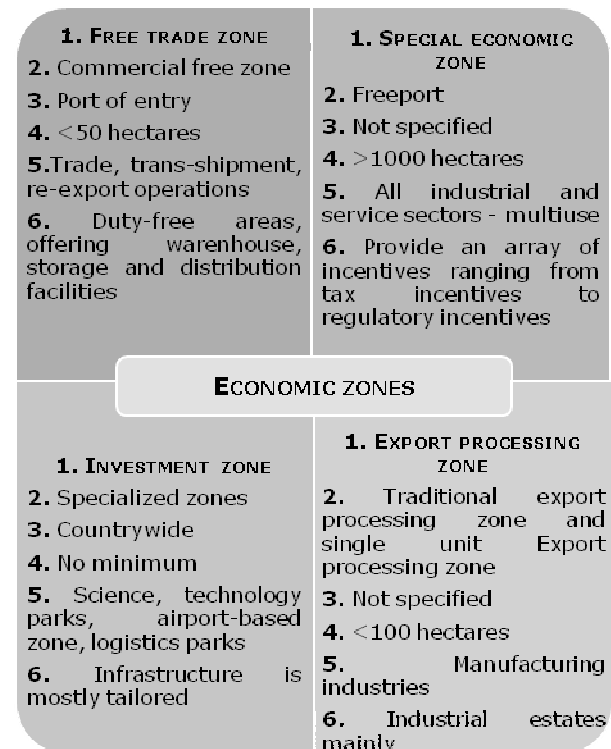
- 1) type of economic zone;
- 2) "also known as" or other used synonyms;
- 3) typical location;
- 4) typical size;
- 5) sectors, industries;

support for investors (infrastructure basically).

As shown in Figure 1, "freeport" is a frequently used synonym for special economic zone; both can provide benefits for various interests of entrepreneurship – all industrial and service sectors. Mainly freeports are located with access to territorial water, mainly – sea.

In the literature related to special economic zones, the importance of the labour ability to communicate in several languages is emphasized in order to increase competitiveness of enterprises (Ezmales et al., 2014). From this point of view, main characteristics or criteria for classification of economic zones may also result from the economic zones' creation aim. For example, researchers distinguish the following objectives:

- to attract foreign direct investment inflows;
- to serve as pressure valves to address high unemployment rates;
- to support national reform strategy;
- to serve as experimental laboratories for the application of new economic policies (Hazakis, 2013).



Source: authors' designed based on OECD, 2010 and Farole et al., 2011

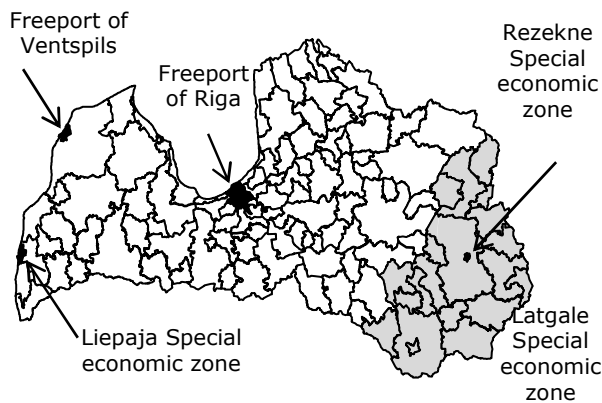
Fig. 1. Types of economic zones and their main characteristics

Only a few countries set official criteria for defining an economic zone, in most cases, as it is currently in Latvia, economic zones are established by a separate Parliament or Presidential decision, without setting any specific criteria, but at the same time emphasizing certain significance for few facts, such as - whether economic zone land is owned by the state or local government.

### 3. Latvia's experience in field of different economic zones

Latvia, since the restoration of sovereignty, established five economic zones in total - two free ports with access to the sea (Freeport of Riga and Freeport of Ventspils), one special economic zone with access to the sea (Liepaja Special Economic Zone) and two special

economic zones without access to the sea - Rezekne Special economic zone and Latgale special economic zone (Figure 2).



Source: authors' designed

Fig. 2. Location of economic zones in Latvia

Location of economic zones in Latvia varies from one single city as Freeport of Riga, Freeport of Ventspils to multi-municipalities as Latgale Special economic zone (grey coloured in Figure 2). Table 1 provides main characteristics about economic zones in Latvia according to criteria given in Figure 1 – size (ha), year of establishment, main sectors and industries.

Table 1

**Characterization of economic zones in Latvia**

No	Characteristics	Freeport of Riga	Freeport of Ventspils	Liepaja Special economic zone	Rezekne Special economic zone	Latgale Special economic zone
1.	Established	n/a	1997	1997	1997	2016
2.	Size, ha	6348	2451	3979	1155	>72735
3.	Main sectors, industries	Bulk, liquid, general cargos. Engineering, chemical industry, wood processing, electronics.				

Source: authors' designed based on information from economic zones in Latvia

Freeport of Ventspils, Liepaja special economic zone and Rezekne special economic zone were established in 1997. According to Freeport of

Riga information, economic zone was established nine centuries ago and during the time, its development can be measured with high level impact on Riga city. Newest economic zone in Latvia is Latgale special economic zone, which was established in 2016.

Two of economic zones are situated in Latgale– least developed region of Latvia; however, other economic zones are situated in regions with relatively higher territory development index, especially in Riga. Mission for all economic zones in Latvia is to attract investments to develop infrastructure and production, and to create new job places. Each economic zone complies with laws and regulations of the Republic of Latvia, and also with state-aid regulations of the European Union. Law of application of taxes in free ports and special economic zones (2002) sets up procedure for application of tax reductions. In the territory of free port, there is an effect of Law on Ports (1994). Activities of economic zones in Latvia are determined by various laws and regulations that are subordinate to one another. Tasks of each economic zone encompass special law, which usually is regarded to investment policy. Base laws of economic zones in Latvia are:

- Freeport of Riga – Riga Freeport Law (2000);
- Freeport of Ventspils - Ventspils Freeport Law (1997);
- Liepaja special economic zone – Law of Liepaja special economic zone (1997);
- Rezekne special economic zone – Law of Rezekne Special Economic Zone (1997);
- Latgale special economic zone – Law of Latgale Special Economic Zone (2016).

Aims of economic zones are tailor-made for each economic zone, for example, aim of Liepaja special economic zone is to promote shipping as industry. Although with access to the sea, this economic zone is not called as freeport. As shown in the second section of this article, the freeport is synonym of special economic zone. Due to this,

it cannot be declared that case of Liepaja special economic zone shows improper use of current economic zone term. In addition, locally the fact how one or another economic zone is named is irrelevant. As it can be seen from the examples provided by economic zones of Latvia (regardless of type), the main aim is integrated territorial development, without accentuating their differences or some sectors to be supported separately.

In 2016, in Latvia there was established a new economic zone, which will exist in one particular planning region - in all municipalities. This is Latgale special economic zone in Latgale planning region, where each of regional municipalities will be allowed to determine their own territory of special economic zone. This approach is similar to the experience of Poland, where economic zones have their own subzones. So far, Latvia has not used this experience and the flexible approach of determining specific boundaries of special economic zone, may be called as its competitive advantage.

Table 1 shows comparison of economic zones territories' size. Latgale special economic zone's subzones are 11.5 times bigger than the second biggest economic zone in Latvia - Freeport of Riga. Interesting is connection between the size of current economic zone and the size of current city, municipality:

- Freeport of Riga - 21 % of Riga city territory;
- Freeport of Ventspils - 44 % of Ventspils city territory;
- Liepaja special economic zone - 55 % of Liepaja city territory;
- Rezekne special economic zone - 24 % of Rezekne city and Rezekne municipality territory;
- Latgale special economic zone - 5 % of Latgale planning region territory.

Second part of article reflects main criteria about different types of economic zones, and they comply with Latvia's experience. As

mentioned before, in Latgale region there exists one more economic zone. According to the Rezekne Special Economic Zone Law, the purpose of Rezekne special economic zone is to attract investments in production, infrastructure development and job creation. Rezekne special economic zone is located in two local governments - Rezekne city and Rezekne municipality. However, the example of Rezekne special economic zone shows that not always economic zone is understood as an area that belongs to one municipality. Size of economic zone can be different from size of local government where economic zone is located. Rezekne is compact, densely populated city with a small proportion of administrative areas, so the infrastructure in some places even goes beyond its territory. In order to ensure Rezekne special economic zone with necessary areas for economic activities, about half of economic zone's size was found in rural parishes (in Rezekne municipality) bordering Rezekne city (Klavis, 2012). In the time of founding Rezekne special economic zone, it was identified as one monolithic region, but later there were made significant changes in the Law of Rezekne Special economic zone - from economic zone territory forests, cemeteries, residential areas, and places where individual construction is developed or all places where industry cannot develop were deleted. In addition, Rezeknes special economic zone territory was supplemented with areas which, according to the municipal territorial plan, were settled as future developing industrial area (Klavis, 2012).

Success of economic zones in Latvia is based on the available infrastructure, for example, competitive advantages of Rezekne special economic zone are its favourable geographical location of the European Union's eastern border near the international motorway and mainline crossroads, favourable tax system, skilled and motivated workforce, stable tradition of cooperation with Russia and other countries, as

well as production cost competitiveness (Ekonomikas ministrija, 2012). Rezekne special economic zone was constructed in compact industrial zone (created in Soviet times) with ready-made infrastructure. Similarly, in Latgale Special Economic Zone, where it is expected that potential entrepreneurs would prefer to use already existing infrastructure. Academic researchers mostly emphasize the importance of infrastructure and economic potential (Dhingra et al, 2009).

However, the misconception has always been that the successful implementation of special economic zones is only predicted by the promulgation of relevant laws and policies prescribing a package of benefits, which the willing and capable investment firms in the zones are to enjoy (Boniface O., 2015). All five economic zones in Latvia promote export growth and industrial activities, which increase the amount of attracted investment. Main support and benefit of using economic zone for investors (economic zone entrepreneurs) are direct and indirect tax allowances to 80 %.

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### Conclusions

- 1) Economic zones are widely used instrument for fostering agglomeration and decreasing disparities between regions within attraction of foreign investment, creation of new job places.
- 2) From various ranges of economic zones, authors distinguished four main types such as free trade zone, special economic zone, investment zone, export processing zone and their basic characteristics, which all follow certain objectives – mainly to provide benefits for interests of entrepreneurship.
- 3) Latvia's experience proves basic characteristics of economic zones and shows the importance of proper understanding about economic zones' competitive advantages.
- 4) Economic zones in Latvia are key aid for less developed regions for boosting socio-economic situation, but at the same time, there is no restriction from government, where to locate economic zones.

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