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Free Trade Zone Study

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Introduction

Purpose

Deloitte & Touche LLP ("Deloitte") has been engaged by Western Economic Diversification Canada ("WD" or "Client") to provide a basic review and description of Foreign/Free Trade Zones ("FTZs") and to prepare the basis for a comparative analysis of certain FTZs chosen for review.

Scope

The scope of our work as presented in this report was limited to a review and basic description of a sample number of FTZs located in foreign jurisdictions, as mutually selected by Deloitte and the Client.

The purpose of this study was to supplement WD's existing research program on FTZs. As such, this study is not intended to be comprehensive, but rather is intended to contribute to WD's objectives of building upon its existing knowledge base so that policy initiatives can be more effectively evaluated and developed.

Our findings and conclusions from the work undertaken in accordance with the scope as presented above are summarized in the remainder of this report.

Approach

In order to establish a conceptual framework for our research and a context for our brief comparative analysis, in **Section One** we provide a basic description of the general features and expected economic benefits of FTZs.

Thereafter, in **Section Two** we provide a description of the FTZs that have been selected for review. In order to maintain consistency in our analysis, a set of core elements have been evaluated for each FTZ. These include a summary of the following six elements:

- General Description;
- Infrastructure;
- Business Sectors;
- Incentives;
- Business Inputs; and
- Investors.

Overview of Free Trade Zones

This section provides a basic description of FTZs, including their standard features and expected economic benefits.

General

The modern concept of FTZs first gained momentum over the last few decades.¹ In 1975 there were 25 countries with FTZ in place, whereas that number had increased to 93 by 1997.² Similarly, it is estimated that approximately 800,000 people were employed within FTZs in 1975 and approximately 4.5 million in 1997.³ As at the beginning of 2007, there were an estimated 2,700+ FTZs around the world, providing employment for approximately 63 million people.⁴

Increased global trade and rapid developments in infrastructure prompted change and adaptation of the FTZ concept and during the last decades there has been numerous different terms for it. Common terms include Free Trade Zone, Export Processing Zone, Free Export Zone and Special Economic Zone.⁵ It has been noted that the different terms over time and space often reflect the specific activities carried out within a particular zone.⁶ In general, however, normal trade barriers such as tariffs and quotas are eliminated in FTZs and bureaucratic requirements are lowered to attract new business and foreign investments. Corporations operating within a FTZ may also be granted certain host country income tax breaks or holidays as an additional incentive. These zones are often located in an underdeveloped part of the host country, and the zones are expected to promote economic activities and thus reduce poverty and unemployment. FTZs are often located at or near a port of entry to facilitate import and export.

Research has established a strong correlation between the presence of FTZs and increasing export trade, and it appears clear that FTZs have become increasingly popular as a policy instrument for the promotion of export oriented FDI.⁷

Standard Features

As noted, FTZs may be designed and established for different reasons and, as a result, the characteristics that define the concept have been described in many different ways. Nevertheless, it appears that a few common characteristics are standard features of the modern FTZ. These features are described in further detail below.

¹ Page 5, *Free Trade Zone and Port Hinterland Development*, United Nations, 2005.

² Page 6, *Export Processing Zones: A Review in Need of Update*, The World Bank, January 1998.

³ *Id.* at page 5.

⁴ www.ilo.org, September 15, 2008.

⁵ Page 5, *Free Trade Zone and Port Hinterland Development*, United Nations, 2005.

⁶ *Ibid.*

⁷ *Ibid.*

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- **Advanced Infrastructure** – The FTZ offers superior quality infrastructure, including, but not limited to, land, office space, utilities, logistics services, business services and other similar facilities.⁸
- **Flexible Regulations** – Corporations established within a FTZ may have access to a streamlined customs process with less bureaucracy and red-tape. Firms seeking to secure establishments within a FTZ typically obtain assistance from a single source service provider in order to obtain the necessary permits and applications. In addition, the legislation governing the day-to-day operations of firms operating within the FTZ (e.g., labour law) is usually more flexible relative to the laws applicable in the host country outside the FTZ.⁹
- **Beneficial (Offshore) Location** – Corporations often choose FTZs for moving their business activities away from the ultimate destination market (offshore) into a location with a low cost structure.¹⁰
- **Export Oriented** – FTZs usually cater to export oriented corporations that produce goods destined for foreign jurisdictions outside of the host country.¹¹
- **Incentives** – Corporate establishment within a FTZ is often coupled with an attractive incentive package, which may include any of the following:
 - Exemption and/or deferral of customs duties;
 - Grants for developing and employing local human resources;
 - Exemption and/or deferral of sales taxes; and
 - Other tax incentives and holidays (e.g., lower Corporate Income Tax than the rest of the host country outside the FTZ).¹²

Economic Benefits

The common expected economic benefits that may be associated with FTZs are noted below.

- **Foreign Exchange Earnings** – The foreign exchange rate may be positively impacted by increased export earnings, which may lead to lower cost imports for domestic buyers or, alternatively, greater imports at a particular exchange rate.¹³
- **Employment Creation and Income Generation** – Establishing a FTZ may lead to urbanization and a shift from agricultural activities to manufacturing, which is expected to be coupled with a

⁸ *Id.* at page 6.

⁹ *Ibid.*

¹⁰ *Ibid.*

¹¹ *Ibid.*

¹² *Id.* at page 7.

¹³ *Ibid.*

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low opportunity cost to expand and diversify the economy. There is an expected net gain in traditional export goods relative to the loss of agricultural output.¹⁴

- **Attraction of Foreign Direct Investment** – FTZs are expected to attract Foreign Direct Investment (“FDI”), which will increase the capital stock of the host country.¹⁵
- **Technological transfer and knowledge spill-over** – FTZs are expected to generate technological transfers, knowledge spill-over and demonstration effects, which will result in production of non-traditional goods by local companies that will benefit from such production as they are forced to manufacture at a higher level with more rigorous quality standards. This will require training of the workforce, staff and management.¹⁶

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ *Ibid.*

Review of Select Free Trade Zones

We reviewed multiple FTZs located in G8 countries as well as other geographical areas in the Asia-Pacific region, South America and Europe, in an attempt to construct a set of FTZs for our initial research. Specifically, in evaluating and selecting suitable FTZs for the analysis, we examined the following characteristics:

- Development status of the host country;
- Economic factors, which may include a) Price/Cost Structure in the host country, b) Availability of Raw Materials, c) Availability of Labour, d) Type of Industry benefitting from the FTZ scheme , and e) Other significant factors;
- Perceived level of success of the FTZ scheme;
- Client's interest in researching a specific FTZ scheme; and
- Trade interest.

On completion of our preliminary assessment of worldwide FTZs based on the above-mentioned parameters, WD was provided with an initial list of FTZs considered to be suitable for the research program. Thereafter, the management of WD selected 11 FTZs located in the following foreign jurisdictions for further research pursuant to the scope of this engagement:

1. United States – Chicago;
2. United States – Long Beach;
3. United States – Harris County;
4. United States – Phoenix;
5. Brazil – Manaus;
6. Ireland – Shannon;
7. China – Waigaoqiao;
8. Japan – Okinawa;
9. Korea – Masan;
10. Singapore; and
11. Mexico.

This section provides a description of these FTZs in accordance with the following six criteria (to the extent suitable information was available from reliable publically available sources):

- General Description;
- Infrastructure;
- Business Sectors;
- Incentives;
- Business Inputs; and
- Investors.

United States Foreign Trade Zones

The different FTZs that are established in the U.S. share certain common features that are described below. These features are equally applicable to the four U.S. FTZs that were chosen for further review, unless specifically stated otherwise.

General Description

In the U.S., FTZs are designated areas licensed by the Foreign-Trade Zone Board. In these areas, special customs procedures may be used. The FTZ program was established to encourage and expedite U.S. participation in international trade and is a mechanism for companies to manage their duty payments. FTZs are considered outside the U.S. Customs territory so goods received into FTZs are generally not subject to duties, tariffs or quotas.¹⁷

There are two types of FTZs - general-purpose zones and subzones. General-purpose zones are established for multiple users, whereas subzones are established for a single user when a general-purpose zone cannot accommodate operations.¹⁸

Incentives

The main incentives associated with all FTZs located in the U.S. are as follows.¹⁹

- ***Inverted Tariffs*** – If a component item or raw material carries a higher duty rate than a finished product, manufacturing or assembly operations within the FTZ can reduce duty liability on such component or raw material by applying a lower duty rate to the finished product rather than to the individual imported component / raw material.
- ***Duty Exemption on Re-Export*** – If a company assembles or manufactures finished products in the FTZ from imported components / raw materials and then exports such finished products to non-U.S. destinations, no customs duty shall be required to be paid.

¹⁷ <http://www.ia.ita.doc.gov/ftzpage/info/summary.html>, July 24, 2008.

¹⁸ Page 1, *Foreign-Trade Zone Program and the City of Phoenix*, June 2008.

¹⁹ <http://foreign-trade-zone.com/benefits.htm>, July 21, 2008.

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- **Duty Elimination on Waste, Scrap and Yield Loss** – If a company has scrap, waste or yield loss from an imported component, no customs duty is exigible on such scrap, waste or yield loss.
- **Weekly Entry Savings** – If a company located in the FTZ imports goods on a regular basis, it may benefit from filing one Customs Entry per week rather than one Customs Entry per shipment.
- **Duty Deferral** – Customs duty is deferred until merchandise is transported from the FTZ to the U.S. for distribution.
- **Inventory Tax Exemption²⁰** – If a company operates in a state that imposes state or local ad valorem tax on inventory maintained within the state (e.g., Texas or Ohio), FTZ designation will exempt all foreign status merchandise from such taxation. Although it is beyond the scope of this study to examine applicable state incentives associated with or complementary to the FTZ, we recommend future research to examine these incentives.
- **State Benefits²¹** – In addition to the above-mentioned incentives, companies may also benefit from state/local incentives.

Chicago Foreign Trade Zone

General Description

The Chicago Foreign Trade Zone (“CFTZ”) comprises of a 60-mile radius from the Chicago city limits. Its grantee (a corporation to which the privilege of establishing, operating and maintaining the FTZ has been granted) is the Illinois International Port District. The CFTZ has two general-purpose zone sites. One site is at Lake Calumet Harbor, and the other one is near O'Hare Airport.

The site at Lake Calumet Harbor has 400,000 square-feet of designated warehouse space and 20 acres of developable land for the storage, handling, processing, manufacturing and/or assembling of foreign goods²².

O'Hare Airport is a part of Chicago Airport System²³. In 2007, O'Hare Airport handled cargo tonnage of 1,690,742 and passenger volume of 76,182,025²⁴.

The CFTZ also has 12 sub zones being operated by the following companies²⁵:

1. Ford
2. Abbott Laboratories
3. Sanofi-aventis U.S. LLC

²⁰ Page 6, *Is a Foreign Trade Zone for you?*, Lamb & Lerch, January 2, 2002.

²¹ <http://www.ia.ita.doc.gov/ftzpage/info/summary.html>, July 24, 2008.

²² <http://www.theportofchicago.com/pages/facilities.html>, July 21, 2008.

²³ <http://www.flychicago.com/Statistics/statisticsarchive.shtm>, July 31, 2008.

²⁴ Page 2, *December 2007 Airport Statistics*, January 24, 2008.

²⁵ <http://ia.ita.doc.gov/Ftzpage/letters/ftzlist.html>, July 24, 2008.

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4. BP Pipeline North America
5. Citgo Petroleum Corp.
6. EXXON Mobil
7. Henkel Corporation
8. Premcor Refining Group
9. Northrop Grumman Corporation
10. Michelin North America, Inc.
11. Medline Industries, Inc.
12. Sony Electronics Inc.

Infrastructure**Energy**

Illinois has access to an abundant supply of electricity (45,000 megawatts) and produces 190 billion kilowatts per year at 61 facilities. In addition, Illinois is a leading major producer of nuclear power, generating approximately 90.9 billion kilowatt hours with 11 nuclear units²⁶.

Telecommunications

The CFTZ has access to an established telecommunications network. Illinois has digital switching that allows high quality, high speed and secure voice, data, and image communications with lower operating costs. Illinois has an elaborate fiber optic network present in the state²⁷.

Transportation**Road Transport**

The CFTZ has access to an established road transportation system. Five federal highways pass through Chicago²⁸ and, about 400 line haul and local cartage carriers provide a variety of motor services²⁹.

²⁶ http://business.illinois.gov/io_energy.cfm, July 31, 2008.

²⁷ http://business.illinois.gov/io_infrastructure.cfm, July 31, 2008.

²⁸ <http://www.theportofchicago.com/index1a.html>, July 21, 2008.

²⁹ <http://www.theportofchicago.com/pages/service.html>, July 21, 2008.

Sea Transport

The CFTZ has access to the Port of Chicago. The Port of Chicago is well established and serves as a link between the inland-river system, the Great Lakes and the global marketplace³⁰.

Rail Transport

Six of America's major railroads pass through Chicago³¹. In addition, the Port of Chicago has excellent terminal and rail switching services³².

Air Transport

Chicago is served by Chicago O'Hare and Midway International airports. Both airports are owned and operated by the City of Chicago and managed, operated and maintained by the Department of Aviation³³.

Financial Sector

Chicago is a major financial centre and the headquarters of the Federal Reserve Bank of Chicago. Three major financial and futures exchanges (Chicago Stock Exchange, the Chicago Board Options Exchange and the Chicago Mercantile Exchange) are located in Chicago. In addition, many major brokerage firms and insurance companies (e.g., Allstate and Zurich North America) are located in Chicago and the surrounding areas.

Business Sectors

The key business sectors operating at the CFTZ are auto, pharmaceuticals, oil and gas, chemicals, aircrafts, and electronics³⁴.

Business Inputs**Raw Materials**

Raw materials may be imported to the CFTZ with deferral of customs duties. In addition, if such raw materials carry a higher duty rate than a finished product, manufacturing or assembly operations within the CFTZ can secure application of a lower duty rate applicable to the finished products.

³⁰ <http://www.theportofchicago.com/index1a.html>, July 21, 2008.

³¹ *ibid.*

³² <http://www.theportofchicago.com/pages/service.html>, July 21, 2008.

³³ <http://www.ohare.com/Aboutus/home.shtm>, July 22, 2008.

³⁴ <http://ia.ita.doc.gov/Ftzpage/letters/ftzlist.html>, July 24, 2008.

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In addition, coal is present in about 65 percent of Illinois' sub-surface. Recoverable coal reserves account for more BTUs than the oil reserves of Saudi Arabia and Kuwait and account for almost 12.5 percent of total U.S. reserves³⁵.

Labour

Chicago and its surrounding metropolitan area have the second largest labour pool in the U.S. of approximately 4.25 million people.

Northwestern University, the University of Illinois, the University of Chicago and other educational institutions ensure a steady influx of skilled labour in the local economy.

Investors

Deloitte was not able to obtain reliable information on the geographical origin of foreign investors that have established a presence in the CFTZ.

Long Beach Foreign Trade Zone

General Description

The Long Beach Foreign Trade Zone ("LBFTZ") is located in Long Beach, southern California, on the Pacific coast. Its grantee is the Board of Harbor, Commissioners of the Port of Long Beach³⁶.

The LBFTZ has nine sub zones being operated by the following companies³⁷:

1. National RV
2. Datatape, Inc.
3. Alps Manufacturing
4. Rauch Industries
5. Shell Oil Products
6. BP West Coast Products LLC
7. Valero Energy Corporation
8. Ricoh Electronics, Inc.

³⁵ http://business.illinois.gov/io_energy.cfm, July 31, 2008.

³⁶ <http://ia.ita.doc.gov/Ftzpage/letters/ftzlist.html>, July 24, 2008.

³⁷ *Ibid.*

9. Eastman Kodak Company**Infrastructure****Energy**

California produced 69.5 percent of the electricity it used in 2007. The remaining part was imported from the Pacific Northwest (8.2 percent) and the U.S. desert southwest (22.3 percent)³⁸.

Telecommunications

The LBFTZ has access to a well established telecommunications network. Major telecommunication services providers operating in that area are AT&T California, T-Mobile USA, Verizon Wireless, Broadwing Communications Corp, and Pac-West Telecomm that provide a wide range of telecommunication services to their customers.

Transportation**Road Transport**

The LBFTZ is located in close proximity to 710 Long Beach freeway, 405 San Diego freeway, 605 San Gabriel River freeway, 110 Harbor freeway, 105 Century freeway, and Route 1 Pacific Coast highway³⁹.

Sea Transport

The LBFTZ is located in close proximity to the Port of Long Beach. The Port of Long Beach is a leading gateway for trade between the United States and Asia. It is the second busiest port in the U.S. and the 15th busiest container cargo port in the world. If combined with the port of Los Angeles, it would be the world's fifth-busiest port complex behind Singapore, Shanghai, Hong Kong, and Shenzhen, China⁴⁰.

Rail Transport

The LBFTZ is located in close proximity to rail transport, which is provided by Union Pacific Railroad and BNSF Railway. These railways carry about half of the trans-shipments from the Port of Long Beach. In addition, the Alameda Corridor connects the Port of Long Beach to the Los Angeles rail hub.

³⁸ <http://energyalmanac.ca.gov/electricity/index.html>, July 31, 2008.

³⁹ <http://www.ci.long-beach.ca.us/about/facts.asp>, July 21, 2008.

⁴⁰ <http://polb.com/about/facts.asp>, July 21, 2008.

Air Transport

The LBFTZ is located in close proximity to Long Beach airport and Orange County/John Wayne airport⁴¹.

Financial Sector

The LBFTZ has access to an established financial network. Banks and financial institutions like 1st Century Bank, Asian Pacific National Bank, Bank of America, Bank of NAPA, Bank of New York, Barclays, offer a wide spectrum of financial services to their customers.

Business Sectors

The key sectors operating at the LBFTZ are auto, small appliances, oil and gas, and electronics⁴².

Business Inputs**Raw Materials**

Raw materials may be imported to the LBFTZ with deferral of customs duties. In addition, if such raw materials carry a higher duty rate than a finished product, manufacturing or assembly operations within the LBFTZ can secure application of a lower duty rate applicable to the finished products.

California has access to abundant mineral resources including, but not limited to, oil, diatomite, gold, magnesium compounds, molybdenum, and perlite⁴³.

Labour

As of 2000, there were 461,522 people residing in Long Beach city. The city's demographics is spread out with 29.2 percent under the age of 18, 10.9 percent from 18 to 24, 32.9 percent from 25 to 44, 18.0 percent from 45 to 64, and 9.1 percent who were 65 years of age or older. The median age was 31 years.

The California State University at Long Beach, the Long Beach City College and DeVry University ensure a steady influx of skilled labour into the local economy.

Investors

Deloitte was not able to obtain reliable information on the geographical origin of foreign investors that have established a presence in the LBFTZ.

⁴¹ <http://www.ci.long-beach.ca.us/about/facts.asp>, July 21, 2008.

⁴² <http://ia.ita.doc.gov/Ftzpage/letters/ftzlist.html>, July 24, 2008.

⁴³ http://www.netstate.com/economy/ca_economy.htm, July 31, 2008.

Harris County Foreign Trade Zone

General Description

The Harris County Foreign Trade Zone ("HCFTZ") is located throughout Houston and Harris County, Texas. Its grantee is the Port of Houston Authority.

The HCFTZ has 15 sub zones being operated by the following companies⁴⁴:

1. DuPont
2. Gulf Coast Maritime
3. Valero Refining
4. Shaffer, Inc.
5. Tuboscope Vetco Int'l
6. Shell Oil Co.
7. Dril-Quip
8. Tadiran Microwave Networks
9. Hydril USA Manufacturing LLC
10. Pasadena Refining System, Inc.
11. EXXON Mobil
12. Houston Refining LP
13. Equistar Chemicals
14. Michelin North America, Inc.
15. Academy Sports & Outdoors

⁴⁴ <http://ia.ita.doc.gov/Ftzpage/letters/ftzlist.html>, July 24, 2008.

Infrastructure

Energy

Houston houses more than 3,000 energy-related establishments. 15 of the nation's 20 largest natural gas transmission companies, 12 of the nation's 20 largest pipeline products companies, nearly 600 exploration and production firms and more than 170 pipeline operators are based in Houston⁴⁵.

Telecommunications

Houston has access to a wide range of high quality telecommunication services. Among telecommunication services providers are companies such as Caprock Communications and AT&T that help users to provide a wide range of services from customer contact centres to data centres, back-office operations and shared-services operations⁴⁶.

Transportation

Road Transport

The HCFTZ has access to established road transportation. The HCFTZ is located in close proximity to Interstate 10, 45 and 610 Loop; U.S. Highway 59, 90, 90 alternate, and 290; and State Highway 3, 6, 146, 225, 249, and 288.

Houston has 575.4 miles of highways and Expressways. Nearly 1,000 trucking companies provide transportation services in this area⁴⁷.

Sea Transport

The HCFTZ has access to an established seaport. The Port of Houston has been ranked first in the U.S. in foreign tonnage for 10 consecutive years, first in imports for 15 consecutive years and second in the U.S. in total tonnage for 15 consecutive years⁴⁸.

Rail Transport

A wide range of products, from processed foods to plastics, is transported annually through the region by more than 700,000 rail cars⁴⁹.

⁴⁵ <http://www.houston.org/industryGuide/energy.asp>, July 31, 2008.

⁴⁶ <http://www.houston.org/industryGuide/communications.asp>, July 31, 2008.

⁴⁷ <http://www.houston.org/whyHouston/gateway.asp>, July 31, 2008.

⁴⁸ <http://www.portofhouston.com/busdev/tradedevelopment/tradestatistics.html>, July 21, 2008.

⁴⁹ <http://www.houston.org/whyHouston/gateway.asp>, July 31, 2008.

Air Transport

The Houston Airport System consists of the George Bush Intercontinental Airport, William P. Hobby Airport and Ellington Field⁵⁰. The Houston Airport System ranks fourth in the country and sixth globally for multi-airport systems⁵¹.

Financial Sector

The HCFTZ has access to an established financial network. Houston has operational presence of 21 foreign banks, representing 11 nations⁵².

Business Sectors

The key sectors operating at the LBFTZ are chemicals, oil and gas, electronics, tires and inner tubes, and sports equipment⁵³.

Business Inputs**Raw Materials**

Raw materials may be imported to the HCFTZ with deferral of customs duties. In addition, if such raw materials carry a higher duty rate than a finished product, manufacturing or assembly operations within the HCFTZ can secure application of a lower duty rate applicable to the finished products.

Texas has abundant mineral resources including, but not limited to, coal, copper⁵⁴, oil and natural gas.

Labour

As of the census of 2000, Harris County had a population of over 3,400,000 people. The population was spread out with 29.00 percent under the age of 18, 10.30 percent from 18 to 24, 33.40 percent from 25 to 44, 19.80 percent from 45 to 64 and 7.40 percent who were 65 years of age or older. The median age was 31 years.

The University of Houston, Rice University, Texas Southern University and other educational institutions ensure a steady influx of skilled labour in the local economy.

⁵⁰ Page 13, *Airport System Fund – An Enterprise Fund of the City of Houston, Texas – Comprehensive Annual Financial Report – Fiscal Year Ended June 30, 2007*.

⁵¹ <http://www.houston.org/whyHouston/gateway.asp>, July 31, 2008.

⁵² *Ibid.*

⁵³ <http://ia.ita.doc.gov/Ftzpage/letters/ftzlist.html>, July 24, 2008.

⁵⁴ <http://tshaonline.org/handbook/online/articles/MM/gpm1.html>, July 31, 2008.

Investors

Deloitte was not able to obtain reliable information on the geographical origin of foreign investors that have established a presence in the HCFTZ.

Phoenix Foreign Trade Zone

General Description

The Phoenix Foreign Trade Zone ("PFTZ") is located in Arizona and has two general-purpose zone sites and nine sub zone sites. One general-purpose zone site consists of approximately 278 acres located at Phoenix Sky Harbor Center (a business park adjacent to Phoenix Sky Harbor International Airport) and approximately 60 acres within the air cargo area of Phoenix Sky Harbor International Airport. The second site has approximately 15 acres and is located within the CC&F South Valley Industrial Center (a multi-owner business park at Seventh Street and Elwood Street) in an industrial area immediately south of downtown in central Phoenix⁵⁵.

There are also the nine sub zones operated by the following companies⁵⁶:

1. Conair Corporation
2. Wal-Mart Stores, Inc. (sub zone is currently deactivated)
3. Intel Corporation
4. STMicroelectronics, Inc.
5. Abbott Laboratories
6. PETS MART
7. SUMCO Southwest
8. Microchip Technology, Inc.
9. American Italian Pasta Co.

⁵⁵ Page 3, *Foreign-Trade Zone No. 75 – City of Phoenix, Arizona Grantee – Zone Schedule*, March 1, 2008.

⁵⁶ *Ibid.*

Infrastructure

Energy

The PFTZ has access to an established energy network. Among electricity providers are companies such as APS and SRP that supply electricity to residential and commercial clients.

Telecommunications

US West is the primary local telecommunication services provider. It has made significant infrastructure investments in Arizona with the development of its Network 21 System. Greater Phoenix is currently one of the top five regional fiber optic deployments in the United States. Greater Phoenix has a system of 15 self-healing fiber optic rings and a local US West fiber network covering 897 square miles⁵⁷.

Transportation

Road Transport

Interstate 10 is the main artery crossing the Southern states in the US (i.e., the Sunbelt). It extends from Los Angeles to Jacksonville, Florida. It enables overnight service from Phoenix to markets with a combined population of more than 10 million people⁵⁸.

Sea Transport

The PFTZ is not situated directly by, but relatively close to seaport facilities of San Diego and Los Angeles.

Rail Transport

Two transcontinental rail lines (the Southern Pacific and the Santa Fe) serve Greater Phoenix. Trailer on flat car (TOFC), container on flat car (COFC) and deramping facilities for TOFC and COFC are available rail services⁵⁹.

Air Transport

Phoenix is served by Sky Harbor International Airport, which is the ninth-busiest airport in the U.S. and 18th in the world for passenger traffic. The airport is served by more than 22 airlines and has non-stop flights to nearly every major city in the U.S.⁶⁰ The Phoenix-Mesa Gateway Airport is located in neighboring Mesa and serves the area's commercial air traffic.

⁵⁷ <http://phoenix.gov/BUSINESS/mrktinfr.html>, July 21, 2008.

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

⁶⁰ *Ibid.*

Financial Sector

The PFTZ has access to an established financial network. Financial institutions, such as World Bank Group, Bank of America, PNC, Fifth Third Bank, BB&T, Bank Of The West and others provide a wide range of financial services in this area.

Business Sectors

Table 2 below shows the key sectors operating at the PFTZ and the primary business activities carried out by the companies located within the PFTZ.

Table 2
Phoenix Foreign Trade Zone
Key Sectors and Business Activities⁶¹

Sector	Business Activities
Aerospace	Manufacturing
Pharmaceuticals	Manufacturing
Food	Manufacturing
Electronics	Manufacturing

Business Inputs

Raw Materials

Raw materials may be imported to the PFTZ with deferral of customs duties. In addition, if such raw materials carry a higher duty rate than a finished product, manufacturing or assembly operations within the PFTZ can secure application of a lower duty rate applicable to the finished products.

Arizona has abundant mineral resources including, but not limited to, copper, gold, silver, coal, molybdenum, and lead⁶².

Labour

The PFTZ has access to rapidly growing Phoenix employment base of more than 1.7 million people. University of Phoenix and Arizona State University ensure a steady influx of skilled labour⁶³ in the local economy.

⁶¹ Page 2, *Foreign-Trade Zone Program and the City of Phoenix*, June 2008.

⁶² <http://www.azgs.az.gov/minerals.shtml>, July 31, 2008.

⁶³ <http://phoenix.gov/ECONDEV/mrktoveremploygrowth.html>, July 21, 2008.

Investors

Deloitte was not able to obtain reliable information on the geographical origin of foreign investors that have established a presence in the PFTZ.

Brazil - Manaus Free Trade Zone

General Description

The Manaus Free Trade Zone (“Manaus FTZ”) is comprised of a manufacturing park, a trading centre and an agricultural and ranching district, all located in Manaus, the capital city of the Amazonas State in northern Brazil.⁶⁴ Manaus has an estimated population of 1.6 million and it has the 4th highest Gross Domestic Product in Brazil.⁶⁵ Currently, 400 companies are operating in the Manaus Industrial Sector, and these companies generate an average annual revenue in excess of U.S. \$10 billion and employ 50,000 people in the Manaus region.⁶⁶

The Manaus FTZ was established in 1967 and is presently managed and promoted by the Manaus Free Trade Zone Superintendence (“Suframa”), a government agency under the Ministry for Development, Industry and Foreign Trade. Suframa is mandated to implement the tax scheme associated with corporate establishments in the Manaus FTZ, and it has the overall responsibility for economic development of the western Amazonas region.⁶⁷

Infrastructure

Energy

Hydroelectric plants generate approximately 90 percent of the Brazilian electric power. Due to long distances between the location of electric power generation and final consumption, Brazil has a well developed transmission network.⁶⁸ Deloitte could not locate reliable public information regarding the electric power supply available to companies operating within the Manaus FTZ. However, in the urban area of the northern Amazonas region electricity is available to 96.8 percent of inhabitants at 110 volts.⁶⁹

⁶⁴ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_01.htm, July 22, 2008.

⁶⁵ www.suframa.gov.br/eng/modelozfm_invista_EN.cfm, July 22, 2008.

⁶⁶ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_03.htm, July 22, 2008.

⁶⁷ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_01.htm, July 22, 2008.

⁶⁸ Pages 134 and 135, *Legal Guide for Foreign Investors in Brazil*, Ministry of External Relations, 2007.

⁶⁹ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_14.htm, July 22, 2008.

Telecommunications

The Manaus FTZ has an established telecommunications network due to large investments by the Government of Brazil.⁷⁰

Transportation

Road Transport

The Manaus FTZ is located close to Highway BR 174, which connects Manaus to Boa Vista in the north. This highway provides paved road transportation access to Venezuela and neighboring countries.⁷¹ Highway BR 319 connects Manaus with Porto Velho in the south.

Sea Transport

The Manaus FTZ is located in close proximity to the Port of Manaus on the Rio Negro, which connects Manaus to many domestic locations via an extensive network of navigable waterways. The Port of Manaus also provides access to the Pacific Ocean and the Atlantic Ocean.⁷²

Rail Transport

There is no rail transport available in Manaus, or within close proximity to the city.⁷³

Air Transport

The Eduardo Gomes International Airport is located in Manaus and is Brazil's 3rd largest airport measured by freight movement. The airport has 2 passenger terminals and 3 cargo terminals, and offers regular scheduled flights via multiple airlines.⁷⁴

Financial Sector

Brazil's national financial sector is comprised of the National Monetary Council ("CMN"), the Central Bank of Brazil, *Banco do Brasil S.A.* and *Banco Nacional do Desenvolvimento Econômico e Social*, as well as other private and public institutions. The CMN is responsible for monetary and credit policies and regulation of the general operations of Brazil's financial institutions.⁷⁵ Deloitte did not, however, obtain reliable public information regarding the specific financial sectors available to corporations that operate within the Manaus FTZ.

⁷⁰ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_07.htm, July 22, 2008.

⁷¹ *Ibid.*

⁷² www.suframa.gov.br/eng/modelozfm_exportacao_EN.cfm, July 22, 2008.

⁷³ www.braziltradenet.gov.br/CDINVESTIMENTO/?Idioma=1, July 22, 2008.

⁷⁴ www.infraero.gov.br/usa/aero_prev_home.php?ai=189, July 22, 2008.

⁷⁵ Page 144, *Legal Guide for Foreign Investors in Brazil*, Ministry of External Relations, 2007.

Business Sectors

The commercial sector, primarily involving imported goods, was the first business sector to be established in the Manaus FTZ at its inception in 1970, which increased tourism and associated service offerings. In 1975 the industrial sector was established as the leading business sector in the Manaus FTZ. Currently, the Manaus FTZ also has an agriculture and ranching district that caters to agriculture and ranching, colonization, eco-tourism, mining projects and environmental protection and research.⁷⁶ Table 3 below shows the predominant industrial sectors of the Manaus FTZ and the main products produced by the companies within the Manaus FTZ.

Table 3
Manaus Free Trade Zone
Industrial Sectors and Products⁷⁷

Industrial Sector	Product
Electric and electronic equipment	Color TVs
Two-wheel vehicles	Cell phones
Watches	3-in-1 stereo equipment
Optics	Video monitors
One-way appliances and goods	Tape deck radio recorders
Toys	Air conditioners
Thermoplastic and metallurgic products	VCRs
	CDs
	Bicycles
	Pocket watches

Incentives

The incentives associated with corporate establishment in the Manaus FTZ are noted below.

Federal Government Incentives

- **Corporate tax reduction** – Eligible corporations may receive a 75 percent corporate tax reduction on “*exploration profits*” until 2013.⁷⁸

⁷⁶ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_11.htm, July 22, 2008.

⁷⁷ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_03.htm, July 22, 2008.

⁷⁸ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_04.htm, July 22, 2008.

Consulting Services

- **Import Tax reduction and exemption** – Eligible corporations established in the Manaus FTZ may receive Import Tax reduction and/or exemption granted by the Federal Government of Brazil as follows:
 - Foreign goods entering the Manaus FTZ that are destined for internal consumption and re-exportation are exempt from Import Tax;
 - Certain eligible foreign goods destined for the western Amazons region are exempt from Import Tax;
 - Import Tax reductions may be applied to eligible "raw materials, intermediate goods, secondary materials and packaging materials" from foreign destinations if these good are used in the manufacturing process of companies established in the Manaus FTZ and the finished goods is destined to another area in Brazil. Such reductions are pending pre-approval from Suframa and certain other statutory and formulary restrictions;
 - Excise Tax exemption applies to eligible foreign goods traded within the Manaus FTZ, as well as to foreign goods utilized within the zone subject to certain restrictions. The Excise Tax exemption is also applicable to goods produced within the Manaus FTZ and to domestic goods entering the zone; and
 - Export Tax exemption for goods produced within the Manaus FTZ.⁷⁹

State Government Incentives

- **Value Added Tax exemption** – The State of Amazonas provides an exemption for VAT to eligible goods for consumption or industrialization or re-exportation by other Brazilian States to the Manaus FTZ;⁸⁰
- **Value Added Tax credit** – The State of Amazonas grants VAT credit equal to the amount payable at the point of origin for goods manufactured in other Brazilian States as these goods enter the Manaus FTZ;⁸¹ and
- **Value Added Tax refund** – VAT on eligible goods is refunded subject to certain conditions.⁸²

Municipal Government Incentives

- **Tax exemptions** – Corporations established in the Manaus FTZ are exempt from paying applicable municipal Housing, Territorial and Urban Real Estate Tax, as well as from paying tax for waste disposal and conservation, for a period of 10 years;⁸³ and

⁷⁹ *Ibid.*

⁸⁰ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_05.htm, July 22, 2008.

⁸¹ *Ibid.*

⁸² *Ibid.*

⁸³ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_06.htm, July 22, 2008.

- **Other Incentives** – The Manaus FTZ offers an exemption from paying a corporate license fee for a period of 10 years, subject to certain conditions.⁸⁴

Business Inputs

Raw Materials

Manaus has access to abundant mineral resources including, but not limited to, oil and gas, limestone, silvinites, kolin, claystone, niobium and tin.⁸⁵

Labour

Corporations established in the Manaus FTZ have access to a qualified and fairly productive workforce. In addition, employees within all business segments have the opportunity to receive continuing labour training.⁸⁶

Investors

Deloitte was not able to obtain reliable information on the geographical origin of foreign investors that have established a presence in the Manaus FTZ.

Ireland - Shannon Free Zone

General Description

The Shannon Free Zone ("SFZ") is located on 600 acres adjacent to the Shannon International Airport in Shannon on the west coast of Ireland.⁸⁷ Currently, 110 companies operate in the SFZ, with a total employment level of 7,200 and an annual trade volume of €3.3 billion.⁸⁸

The SFZ was established in 1959 and is managed and promoted by Shannon Development, an Irish government corporation, presently mandated to oversee the economic growth and development of the Shannon Region. The Shannon Region covers a 10,000 square kilometer area spanning the counties of Clare, Limerick, North Tipperary, South Offaly and North Kerry. Collectively, these counties have a population of over 450,000 people.⁸⁹

⁸⁴ *Ibid.*

⁸⁵ www.suframa.gov.br/eng/modelozfm_invista_EN.cfm, July 22, 2008.

⁸⁶ www.suframa.gov.br/publicacoes/site_suframa/english/pagina_07.htm, July 22, 2008.

⁸⁷ Page 4, *Invest in Shannon Ireland – Our business is helping your business grow – Shannon as a location for aviation-related activities*, Shannon Development, January 2008.

⁸⁸ Page 4, *Shannon Region – Investment Location News*, Shannon Development, Winter Issue 2007/ 2008.

⁸⁹ Page 1, *Shannon Development Annual Report*, 2006.

Infrastructure

Energy

The national provider of electricity in Ireland operates 24 power stations nationwide with a total capacity of 4164 Mw. The national grid comprises of high voltage lines, and industrial users are typically supplied at high voltage or, alternatively, at medium voltage. However, low voltage supplies are also available. The average cost per Kw hour for electricity is €0.075.⁹⁰

Telecommunications

The Shannon region has a well developed telecommunications infrastructure, with broadband connectivity to the Irish national backbone.⁹¹ The Irish telecommunications market is de-regulated with several market participants, and recent investments by these companies have resulted in advanced fiber-optic networks with national and international connectivity.⁹²

Transportation

Road Transport

The SFZ is located on the N18 main national route, approximately 18 kilometers from Limerick, 129 kilometers from Cork and 222 kilometers from Dublin.⁹³

Sea Transport

The SFZ is not situated directly by, but relatively close to seaport facilities. The nearest roll on/roll off port is in Cork and such services are also available in Dublin. The closest container facility is the Shannon Foynes Port, which is 56 kilometers away from the SFZ.

The ports around the Shannon estuary comprise of four special purpose ports catering to particular industries, as well as two general purpose ports at Foynes and Limerick. These ports serve all modalities including dry and liquid bulks, break-bulks and lift on/lift off containers. There is a liner service operating directly from the port at Foynes to Rotterdam for European or transshipment.⁹⁴

⁹⁰ www.shannonireland.com, July 17, 2008.

⁹¹ Page 20, *Invest in Shannon Ireland – Our business is helping your business grow – Shannon as a location for aviation-related activities*, Shannon Development, January 2008.

⁹² www.idaireland.com, July 17, 2008.

⁹³ www.shannonireland.com, July 17, 2008.

⁹⁴ *Ibid.*

Rail Transport

An Inter City Rail Link is located in Limerick. The Inter City Rail Link provides daily connections to Dublin and Cork.⁹⁵

Air Transport

The Shannon International Airport has an annual capacity of 4.5 million passengers.⁹⁶ During 2007, the Shannon International Airport recorded 3.2 million terminal passengers; *i.e.*, passengers who either begin or end their journey at the airport.⁹⁷ Regular scheduled services to destinations in the U.K., U.S. and Europe are provided by multiple airlines.

Financial Sector

SPZ has access to four domestic clearing houses, as well as to international financial institutions.⁹⁸

Business Sectors

Table 4 below shows the key sectors operating at the SFZ and the primary business activities carried out by the companies located within the SFZ.

**Table 4
Shannon Free Zone
Key Sectors and Business Activities⁹⁹**

Sector	Business Activities
Aerospace	Customer Support & Contact
Software	Shared Services
Engineering	Supply Chain Management
Healthcare	Financial Services
Pharmaceuticals	Headquarters & E-Business
Electronics	Production

⁹⁵ *Ibid.*

⁹⁶ ⁹⁶ Page 20, *Invest in Shannon Ireland – Our business is helping your business grow – Shannon as a location for aviation-related activities*, Shannon Development, January 2008.

⁹⁷ Page 21, Dublin Airport Authority Annual Report, 2007.

⁹⁸ Page 3, *Invest in Shannon Ireland – Our business is helping your business grow*, Shannon Development, January 2008.

⁹⁹ ⁹⁹ Page 4, *Invest in Shannon Ireland – Our business is helping your business grow – Shannon as a location for aviation-related activities*, Shannon Development, January 2008.

Incentives

The incentives associated with corporate establishment in the SFZ are noted below.

- **Corporate tax rate of 12.5 percent** – Effective as of January 1, 2003, Ireland’s corporate tax rate is 12.5 percent on all trading profits. In addition, the 10 percent corporate tax rate for eligible “manufacturing” trades is still available until 2010, as long as the trade qualified for such rate before July 30, 1998. A corporate tax rate of 25 percent applies to non-trading income.¹⁰⁰
- **Free port benefits** – SFZ is a customs free zone with a system that allows deferral of duty payable on imported goods from non-EU countries, until such time the goods leave the SFZ destined for another EU country. Companies may obtain approval to import goods duty-free from outside the EU for processing and re-exportation to non-EU countries. Importation of goods from within the EU is exempt from duties. The SFZ is rated zero for VAT.¹⁰¹
- **Grants** – Shannon Development offers grants to eligible prospective companies seeking to establish a presence in the SFZ, as well as to certain companies that are already operating within the SFZ. The following types of grants are available:
 - Employment Grants;
 - Research and Development (“R&D”) Grants;
 - Training Grants; and
 - Capital Grants.¹⁰²
- **Other Incentives** – Companies established in the SFZ may also be eligible for other incentives. These include, but are not limited to, R&D tax credits and exemption for Capital Gains Tax on share disposals.¹⁰³

Business Inputs

Raw Materials

Please refer to the “Incentives” section above.

¹⁰⁰ Page 3, *Guide to Tax in Ireland*, IDA Ireland, 2007.

¹⁰¹ *Id.* at page 6, and Page 3, *Invest in Shannon Ireland – Our business is helping your business grow*, Shannon Development, January 2008.

¹⁰² Page 3, *Guide to Tax in Ireland*, IDA Ireland, 2007.

¹⁰³ Page 2, *Invest in Shannon Ireland – Our business is helping your business grow*, Shannon Development, January 2008.

Labour

The Irish population is the youngest in Europe. Companies established in the SFZ have access to a well educated workforce with a productivity output of an estimated hourly GDP per capita of U.S. \$ 45.33.¹⁰⁴ Ireland has nearly one million people in full-time education and 60 percent of people that complete high school continue with further education, primarily within business, engineering and computer science. The SFZ is located 25 kilometers from The University of Limerick and The Limerick Institute of Technology. Other secondary education institutions such as the NUI Galway and University College Cork are located 88 kilometers and 128 kilometers away respectively.¹⁰⁵

Investors

Table 5 below shows the geographical origin of foreign investors that have established a presence in the SFZ.

Table 5
Shannon Free Zone
Foreign Investments¹⁰⁶

Origin of Investment	Percent %
U.S.	57
Continental Europe	27
U.K	6
Canada	4
Japan	2
Other	4

China - Waigaoqiao Free Trade Zone

General Description

The Waigaoqiao Free Trade Zone (“WFTZ”) is located in Shanghai, China. The WFTZ was established with the approval of the State Council in June 1990 and is located on 10 square kilometers of designated area. Currently, it is the oldest and largest of China’s free trade zones¹⁰⁷.

¹⁰⁴ *Ibid.*

¹⁰⁵ *Id.* at page 3.

¹⁰⁶ *Id.* at page 1.

¹⁰⁷ <http://www.investment.gov.cn/2005-10-27/1130425544581.html>, July 22, 2008.

Infrastructure

Energy

The Waigaoqiao power station is located in the eastern part of the WFTZ and provides 5,400,000 kilowatts of power. In addition, five 35,000 kv. transformer substations supply around 200,000 kv. of electricity. Waigaoqiao plans to construct 134 additional 35,000 kv. transformer substations and one 220,000 kv. transformer substation to cater to the growing energy requirements in the zone¹⁰⁸.

Telecommunications

The WFTZ has a well developed telecommunication infrastructure, with ray cables, ESDN lines and ADSL lines. The companies based in the WFTZ have access to various IT services, including high speed and broad band internet connectivity.

Transportation

Road Transport

The WFTZ has access to an established road transport. Yanggao Road, a 50 meter wide and 24.5 kilometer long highway, connects the WFTZ with Puxi through Yangpu and Nanpu suspension bridges. The south-north inner beltway in the downtown area, Yan'an Dong Channel tunnel and Yan'an inner beltway speed up traffic from the city centre to the WFTZ. The Outer Circle that runs across Huangpu River at Zhang Huabang area through the east side of WFTZ reaches Wu Song Harbor area¹⁰⁹.

Sea Transport

The WFTZ has access to an established sea transport. Waigaoqiao Port is one of the most important logistical hubs of the Yangtze Delta Economy and the most important area for Shanghai's International Shipping Industry¹¹⁰.

Rail Transport

The WFTZ is serviced by a light rail system.

Air Transport

The WFTZ is served by Hongqiao International Airport and Pudong International Airport¹¹¹.

¹⁰⁸ *Ibid.*

¹⁰⁹ *Ibid.*

¹¹⁰ *Ibid.*

¹¹¹ http://www.investing-shanghai.com/investguidance/opportunity_Waigaoqiao.asp, July 24, 2008.

Financial Sector

The WFTZ has access to a well established financial network. There are more than 3,000 financial institutions located in Shanghai, including more than 50 foreign bank branches¹¹².

Business Sectors

There are many companies operating in the WFTZ belonging to industries like clothing, electronics and telecommunications. However, the principal industry operating in the WFTZ is semiconductors. Main activities performed in the WFTZ relate to trading, manufacturing and processing, warehousing and distributions, and bonded logistics and transportation¹¹³.

Incentives

The WFTZ provides the following incentives¹¹⁴:

- **Customs duty and VAT exemption** – Companies operating in the WFTZ are exempted from payment of customs duties and VAT on the importation of raw materials, machinery, manufacturing components, and office equipments. This exemption does not apply to raw materials and components imported for use in products to be sold domestically. Imported goods can be stored within the WFTZ, and simple processing is permitted.
- **Foreign exchange incentives** - The WFTZ is the only place in China where foreign exchange values may be fully retained.
- **FDI incentives** – Foreign-funded companies operating in WFTZ are entitled to conduct international trading, manufacturing, processing, warehousing, logistics and exhibition of bonded commodities. Foreign-funded companies are also entitled to conduct trade related services, like testing and maintenance.
- **Government subsidy** - Foreign companies investing in the WFTZ zone may enjoy the government preferential tax treatment and special subsidies from the Shanghai Municipality and the Pudong New Area government, subject to conditions.

Business Inputs

Raw Materials

Due to an established transportation network, the WFTZ has access to main raw materials. However, Deloitte could not obtain reliable public information regarding raw materials available to companies operating within the WFTZ.

¹¹² <http://www.nacs.com.hk/wfoe/SEZ.htm>, July 24, 2008.

¹¹³ *Ibid.*

¹¹⁴ <http://www.investment.gov.cn/2005-10-27/1130425544581.html>, July 22, 2008.

Labour

The WFTZ has access to a significant pool of human resources comprising of approximately 16 million people¹¹⁵.

Shanghai Jiao Tong University ensures a steady influx of skilled labour in the local economy. Shanghai Jiao Tong University is one of the oldest and most influential universities in China that is run by the Ministry and Shanghai Municipality¹¹⁶.

Investors

The WFTZ attracted more than 8,000 projects, including 6,000 foreign investments from 82 countries, by the end of 2004. The total investment in Waigaoqiao amounts to USD 10 billion¹¹⁷.

Japan - Okinawa Special Free Trade Zone

General Description

The Okinawa Special Free Trade Zone ("OSFTZ") is located in Japan on approximately 122 hectares of land. Out of 122 hectares, approximately 89.6 hectares is available for corporate use. The OSFTZ was established in March 1999 to promote industry and trade in Okinawa. The OSFTZ is regulated by Okinawa Promotional Special Measures Law¹¹⁸.

Infrastructure

Energy

On Okinawa Island, transformed voltages of 66kV, 22kV, 6.6kV and 200/100V are provided through 132kV basic system. In the Nakagusuku Bay Port Development Industrial Complex, transformed voltages of 66kV and 200/100V are provided by the closest 6.6kV transformer substation¹¹⁹.

Telecommunications

The OSFTZ has an excellent telecommunication network. Development of this network is supported by Japanese government through the Okinawa Stimulus Plan established in July 2002.¹²⁰

Transportation

¹¹⁵ <http://www.nacs.com.hk/wfoe/SEZ.htm>, July 24, 2008.

¹¹⁶ <http://www.sjtu.edu.cn/english/about/index.htm>, July 31, 2008.

¹¹⁷ <http://www.investment.gov.cn/2005-10-27/1130425544581.html>, July 22, 2008.

¹¹⁸ Page 7, *Welcome to a Business Paradise – Industrial Site Promotion Guide – Okinawa Special Free Trade Zone*

¹¹⁹ *Id.* at page 6.

¹²⁰ http://www.dosite.go.jp/e/pj/tele_com.html, July 31, 2008.

Road Transport

Three main routes (National Route 329 on the east coast, National Route 58 on the west coast and the Okinawa Expressway) connect all parts of Okinawa Island. Okinawa Expressway links Naha City and Nago City. The OSFTZ is adjacent to a prefectural road (the Okinawa City Loop) and is located approximately four kilometers from Route 329, nine kilometers from the expressway and 27 kilometers from Naha International Airport¹²¹.

Sea Transport

Naha Port will assume the function of an international logistic base due to its geographical location, the 7.8 hectares site adjacent to the domestic cargo wharf, and access to 17 domestic shipping routes to major Japanese cities, including Tokyo, Nagoya, Osaka, and Hakata¹²².

Rail Transport

Okinawa is served by the Okinawa Monorail. The Okinawa Monorail comprises of 15 stations and connects the Naha Airport with Shuri.

Air Transport

Naha International Airport has a 3,000-meter runway and hosts an air network that connects 18 cities within Japan and Taipei, Seoul, Shanghai and Manila.

It is expected that Okinawa will become a hub for international distribution in the Asia-Pacific region after the Asia Gateway Framework announcement by the Japanese government and All Nippon Airways (ANA) increasing the use of Okinawa as an international base for cargo to Asia¹²³.

Financial Sector

The OSFTZ has access to an established financial network. In addition, Okinawa Development Finance Corporation offers long-term financing at low interest rates.

Business Sectors

As of October 2007, there were 22 enterprises operating in the OSFTZ. Among them are enterprises producing semiconductor radiation detectors, liquid crystal backlight testing devices, flexible print circuit board production devices and precision grind jigs¹²⁴.

Incentives

The OSFTZ provides the following incentives:

¹²¹ Page 4, *Welcome to a Business Paradise – Industrial Site Promotion Guide – Okinawa Special Free Trade Zone*

¹²² *Id.* at page 20.

¹²³ *Id.* at page 19.

¹²⁴ *Id.* at page 16.

Consulting Services

- **Bonded Area** - The bonded area is a designated area or facility where imported goods can be stored, processed or exhibited without payment of tariff or domestic consumption tax. Companies operating within the bonded area benefit from the following¹²⁵:
 - *Duty Exemption on Re-export* – If processed goods are re-exported, no tariffs and domestic consumption taxes are due.
 - *Duty Deferral* – Imported goods can be stored, inspected and sorted with deferment of tariffs and consumption tax. Tariffs and consumption tax needs to be paid only when the imported goods are shipped into the domestic market.
 - *Duty Elimination on Defective Goods* - If defective goods are disposed, no tariffs and consumption tax are due.

- **Incentives for National Taxes** – Companies operating in the OSFTZ can select one of the following three incentives for national taxes¹²⁶:
 - *Income Tax Reduction* – 35 percent of income earned will be exempt from corporate tax and corporate residence tax for the first 10 year following establishment of manufacturing, packaging and warehousing business with 20 or more full time employees.
 - *Investment Tax Deduction* – For businesses installing or expanding facilities within OSFTZ, 15 percent of machinery and equipment costs and 6 percent of building costs will be deducted from corporate tax.
 - *Special Depreciation* - For businesses installing or expanding facilities within OSFTZ, 50 percent of machinery and equipment costs and 25 percent of building costs will be approved as special depreciation.

- **Incentives for Tariffs** – Companies operating in the OSFTZ can benefit from the following two incentives for tariffs¹²⁷:
 - *Selection of Items to which Tariffs Apply* – When importing products for domestic consumptions after processing or manufacturing using foreign freight, companies can choose whether the tariffs will be applied to raw materials or processed / manufactured products.
 - *Reduction in Approval Fee for Bonded Area* – 50 percent reduction of the approval fee for bonded storage facilities, bonded factories, bonded exhibition facilities, and general bonded area.

- **Incentives for Local Taxes** – Companies operating in the OSFTZ can benefit from the following three incentives for local taxes¹²⁸:

¹²⁵ *Id.* at page 8.

¹²⁶ *Id.* at page 9.

¹²⁷ *Ibid.*

¹²⁸ *Ibid.*

Consulting Services

- *Exemption from Business Tax* – For businesses installing or expanding facilities within OSFTZ, a portion of the business tax will be exempt for 5 years.
- *Exemption from Real Estate Acquisition Tax* – For businesses installing or expanding facilities within OSFTZ, a portion of the real estate acquisition tax will be exempt.
- *Exemption from Fixed Property Tax* – For businesses installing or expanding facilities within OSFTZ, a portion of the fixed property tax will be exempt for 5 years.
- **Financing** – Long-term financing is offered by the Okinawa Development Finance Corporation to businesses operating in the OSFTZ at low interest rates¹²⁹.
- **Subsidies for Business Establishment and Relocation** – Subsidies for business establishment and relocation are available to eligible manufacturing businesses, high technology oriented manufacturing businesses and information and communication businesses¹³⁰.
- **Subsidy for Distribution** – Manufacturing of products within the OSFTZ and their shipment out of Okinawa are eligible for subsidy for distribution. Amount of the subsidy depends on the number of shipped containers with a maximum annual cap¹³¹.
- **Subsidies for Employment and Training** – Subsidies are available for employment of young Okinawans and employment development are available for eligible companies operating in the OSFTZ¹³².
- **Industrial Development Districts**– Companies operating in the Industrial Development Districts can benefit from incentives for national taxes and prefectural and municipality taxes¹³³.

Business Inputs

Raw Materials

Raw materials may be imported to the OSFTZ with deferral of customs duties. In addition, if such raw materials carry a higher duty rate than a finished product, manufacturing or assembly operations within the OSFTZ can secure application of a lower duty rate applicable to the finished products.

Labour

Okinawa has the highest rate of unemployment in Japan of 13.2 percent and, therefore, there are many individuals able to take work positions. Furthermore, Okinawa has the highest birthrate of 1.72

¹²⁹ *Id.* at page 10.

¹³⁰ *Id.* at page 11.

¹³¹ *Id.* at page 12.

¹³² *Ibid.*

¹³³ *Id.* at page 17.

and it is anticipated that Okinawa will continue to have a sufficient workforce into the future. Okinawa also has the lowest standard wages of about 75 percent of the national average¹³⁴.

Okinawa has national and prefectural vocational schools and other educational institutions, including the University of the Ryukyus and Okinawa National College of Technology, which serve to meet the demands of industry and support technological advancement¹³⁵.

Investors

Deloitte was unable to obtain reliable information on the geographical origin of foreign investors that have established a presence in the OSFTZ.

Korea - Masan Free Trade Zone

General Description

The Masan Free Trade Zone ("MFTZ") is an industrial complex-based FTZ comprised of approximately 236 acres, divided into three separate but neighboring sections, all located adjacent to the Masan Seaport in the Bay of Masan, on the southern portion of the Korean peninsula.¹³⁶ During 2005, the MFTZ generated a total of U.S. \$4.241 billion in exports and U.S. \$2.326 billion in imports.¹³⁷ Currently, in excess of 80 companies, including notable multinationals such as Sony, Nokia and Sanyo, operate within the MFTZ.¹³⁸

The MFTZ was established in 1970 as Korea's first Free Export Zone catering to foreign investment in the manufacturing and processing industry. In July of 2003, the MFTZ was re-designated as a FTZ to accommodate other areas of business activity, including logistics, warehousing, transport and cargo, merchandising and data processing. The MFTZ is managed and promoted by the Masan Free Trade Zone Administration Agency, a government agency under the Ministry of Knowledge Economy, which is presently mandated for policy making regarding industry, trade, energy and resources in Korea.¹³⁹

Infrastructure

Energy

Electric power is available up to 50,000 Kw and the companies operating within the MFTZ have access to gas through a 100 mm pipe at a pressure of 6 kg/cm². Industrial water is supplied from a reservoir approximately 30 kilometers away at a daily rate of 10,000 tons.¹⁴⁰

¹³⁴ Page 16, *Welcome to a Business Paradise – Industrial Site Promotion Guide – Okinawa Special Free Trade Zone*

¹³⁵ Page 14, *Welcome to a Business Paradise – Industrial Site Promotion Guide – Okinawa Special Free Trade Zone*

¹³⁶ www.ftz.go.kr/eng/masanFTZ/aboutMFTZ.jsp, July 22, 2008 and <http://masan.momaf.go.kr/english/index.html>, July 22, 2008.

¹³⁷ Page 58, *Guide to Investing in Korea*, Invest Korea, February 2008.

¹³⁸ www.ftz.go.kr/eng/masanFTZ/aboutMFTZ.jsp, July 22, 2008 and <http://masan.momaf.go.kr/english/index.html>, July 22, 2008.

¹³⁹ <http://english.mke.go.kr/language/eng/about/history.jsp>, July 22, 2008.

¹⁴⁰ www.ftz.go.kr/eng/investment/supporting.jsp, July 22, 2008.

Telecommunications

The MFTZ has broadband connectivity to the Korean national backbone and access to approximately 2,400 land-lines for telephone service.¹⁴¹ The Korean Information and Communication Technology infrastructure is well developed and Korea was ranked at the top of the digital opportunity index (Internet penetration rate, telecom spending-to-income ratio, rate of Internet use etc.) according to a survey among 181 economies conducted by the International Telecommunication Union.¹⁴² Current investments in broadband convergence networks are expected to be a milestone towards achieving ubiquitous nation-wide broadband connectivity. In addition, innovative technologies such as wireless broadband and telematics wireless telecommunication integration technology are available.¹⁴³

Transportation

Road Transport

The MFTZ is located in close proximity to expressways and national roadways. It is approximately 8 kilometers away from the Gu-Ma Highway with access to Daegu, and 4 kilometers away from the Namhae Highway with access to Gwangju and Busan. Seoul is 388 kilometers away to the south and Busan 46 kilometers away to the west (via the Namhae Highway).¹⁴⁴

Sea Transport

The MFTZ is located in direct proximity to the Masan Seaport; in fact, pier 3 of that port is within the boundaries of the MFTZ. The Masan Seaport has an annual cargo volume in excess of 10 million tons and caters to container freight, car freight, general cargo freight (e.g., scrap iron and timber) and exclusive cargo freight (e.g., oil). It also has regular liner services between Korea and Japan, South-East Asia and North-East Asia.¹⁴⁵

In addition, the MFTZ is relatively close to the Busan Port, which in 2006 was the world's 5th largest container port with an annual cargo volume of over 12 million tons.¹⁴⁶

Rail Transport

The MFTZ is situated on the Gyeongui rail line (the Masan station), which connects Busan and Mokpo.¹⁴⁷ Korea has high-speed rail lines between Busan and Seoul, and Seoul and Gwangju, which were completed in 2004. At that time, Korea was 1 of 5 countries in the world with a high-speed bullet train system. A second phase of construction of this high-speed line, with an expected completion in 2017, will connect the western and eastern portions of the Korean peninsula.¹⁴⁸

¹⁴¹ *Ibid.*

¹⁴² Page 12, *Investment Environment & Business Opportunities*, Invest Korea, September 2007.

¹⁴³ *Ibid.*

¹⁴⁴ www.ftz.go.kr/eng/investment/conditions.jsp, July 22, 2008.

¹⁴⁵ *Ibid* and <http://masan.momaf.go.kr/english/index.html>, July 22, 2008.

¹⁴⁶ Page 28, *Investment Environment & Business Opportunities*, Invest Korea, September 2007.

¹⁴⁷ www.ftz.go.kr/eng/investment/supporting.jsp, July 22, 2008.

¹⁴⁸ Page 12, *Investment Environment & Business Opportunities*, Invest Korea, September 2007.

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In addition, during 2007, tests were conducted on two lines for a Trans-Korean Railway, which is planned to eventually connect with the Trans-Siberian Railway, the Trans-China Railway, the Trans-Mongolian Railway and the Trans-Manchurian Railway.¹⁴⁹

Air Transport

The Gimhae International Airport is located approximately 35 kilometers away from the MFTZ, and direct airport shuttle service is available from the Masan downtown area to the airport every 15 minutes.¹⁵⁰ The Gimhae International Airport has an annual capacity of 2.9 million passengers and regular cargo transportation is available non-stop to China, Japan and Russia. Additionally, the airport offers regular service to domestic destinations such as Seoul, Jeju and Gwangju. Another airport is located 58 kilometers away in Sacheon.¹⁵¹

Financial Sector

Corporations that operate within the MFTZ have access to a network of support offices, which includes, among other things, finance and insurance institutions.¹⁵²

Business Sectors

Table 6 below shows the business sectors operating at the MFTZ, and the business activities carried out by the companies located within the MFTZ as a result of the eligibility criteria for corporate establishment within the zone.

¹⁴⁹ *Ibid.*

¹⁵⁰ www.ftz.go.kr/eng/investment/supporting.jsp, July 22, 2008.

¹⁵¹ www.ftz.go.kr/eng/investment/conditions.jsp, July 22, 2008.

¹⁵² *Ibid.*

Table 6
Masan Free Trade Zone
Sectors and Business Activities¹⁵³

Sector	Business Activities
Textile, clothing, leather and shoes	Export oriented manufacturing
Non-ferrous metals	Wholesale
Primary metals	Logistics (e.g., shipping, packing, processing and distribution)
Fabricated metals and machinery equipment	Industrial support services
Electric and electronic equipment	
Other	

Incentives

The incentives associated with corporate establishment in the MFTZ are noted below.

- **Corporate tax reduction and exemption** – Manufacturing companies that invest a minimum U.S. \$10 million and logistics companies that invest a minimum U.S. \$5 million may be eligible to receive a 100 percent national corporate tax exemption for the first 3 years of operations, and a 50 percent reduction for the following 2 years.¹⁵⁴
- **Local tax reduction and exemption** – Eligible corporations established in the MFTZ may receive a 100 percent exemption on local acquisition, registration, property and aggregate land taxes, and an additional 50 percent reduction for a period of 2 years thereafter.¹⁵⁵
- **Customs duties deferral** – Customs duties are deferred on goods imported to the MFTZ.¹⁵⁶
- **Value Added Tax exemption** – Importation of goods to the MFTZ, as well as inter-zone trade is exempt from VAT.¹⁵⁷

¹⁵³ Page 18, *Where to Invest - Business Zones and Industrial Complexes*, Invest Korea, October 2005 and http://english.gsnd.net/03_business/sub_02_01_07.jsp?mmain=3&sub1=2&sub2=1&sub3=1&gubun=7, July 22, 2008.

¹⁵⁴ Page 24, *Where to Invest - Business Zones and Industrial Complexes*, Invest Korea, October 2005

¹⁵⁵ *Ibid.*

¹⁵⁶ *Ibid.*

¹⁵⁷ *Ibid.*

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- **Other Incentives** – The MFTZ offers a number of other incentives to eligible corporations. These include, but are not limited to, the following:
 - A one-stop service system that includes assistance in obtaining governmental permits and incentives, and a network of service providers within finance, insurance, health care and customs;
 - Cash grants for land costs, construction, machinery, materials and business set-up;
 - Rent exemption for eligible corporations for a period of 10 years; and
 - Financial support for medical treatment, education and housing.¹⁵⁸

Business Inputs

Raw Materials

Raw materials for manufacturing and processing may be imported without VAT and with customs duties deferred.

Labour

The Korean workforce is well educated with approximately 49 percent of its population in the ages of 25 to 34 having achieved at least tertiary education as of 2007. During that same year, Korean students made up the largest percentage of foreign students at Chinese and U.S. educational institutions. In addition, Korea's workforce is among the top ranking economies among the members of the Organization for Economic Cooperation and Development in terms of annual hours worked and labour productivity.¹⁵⁹

Investors

Deloitte was not able to obtain reliable information on the geographical origin of foreign investors that have established a presence in the MFTZ. However, Table 7 below shows the inward Foreign Direct Investment ("FDI") in Korea by industry during 2006, and Table 8, conversely, shows the FDI in Korea by geographical region during that year.

¹⁵⁸ www.ftz.go.kr/eng/investment/incentive.jsp, July 22, 2008.

¹⁵⁹ Page 9, *Investment Environment & Business Opportunities*, Invest Korea, September 2007.

Table 7
Korea
FDI by Industry
2006¹⁶⁰

FDI by Industry	U.S. \$ billion
Finance and insurance	3.0
Electrical and electronics	1.8
Distribution and logistics	1.0
Restaurants and hotels	1.1
Chemicals	0.8
Business services	0.7
Others	2.8

Table 8
Korea
FDI by Geographical Region
2006¹⁶¹

FDI by Industry	U.S. \$ billion
EU	5.0
Japan	2.1
U.S.	1.7
Others	2.4

Free Trade Zones in Singapore

General Description

Singapore is a small nation comprised of approximately 707 square kilometers of land mass, but it has five FTZs within its boundaries.¹⁶² These FTZs are established in accordance with the Free Trade Zone Act of Singapore to facilitate entrepôt trade and certain repacking, sorting and re-conditioning of

¹⁶⁰ *Id.* at page 4.

¹⁶¹ *Id.* at page 5.

¹⁶² Page 1, *Singapore in Figures 2008*, Singapore Department of Statistics, 2008, and www.business.gov.sg/index.htm, July 23, 2008.

goods.¹⁶³ Singapore's FTZs are largely divided in two categories: four of the FTZs are catering to seaborne cargo and located within or adjacent to a port; the fifth is catering to airborne cargo and situated at the Singapore Changi Airport.

Given the small land mass of Singapore relative to the number of current FTZs in the country, we believe that the descriptive factors in this section are generally equally applicable to all such FTZs. Accordingly, the continued discussion below shall not focus on a specific FTZ unless the factual circumstances require otherwise.

Infrastructure

Energy

The electricity and gas sectors in Singapore have undergone a liberalization process over the past few years to allow for open markets and more competition. There are currently several companies generating electricity and the total national generation capacity was approximately 8,900 Mw as at the end of 2003. Natural gas is imported from Malaysia and Indonesia, and is utilized for approximately 60 percent of the total electricity generation in Singapore.¹⁶⁴

Telecommunications

Corporations operating within Singapore's FTZs have access to a very well developed information technology and telecommunications network. As a result of a government initiative introduced in 2001, Singapore has a nation-wide broadband network with direct international connectivity. Further development of the national network is underway and includes ubiquitous fiber optic capabilities with an expected completion in 2015.¹⁶⁵

Transportation

Road Transport

As at the end of 2006, Singapore had a total of 3,262 kilometers of roads, which included expressways, arterial roads and local roads *etc.*¹⁶⁶

Sea Transport

The Port Authority of Singapore operates four container terminals and two multi-purpose terminals throughout Singapore. Together, these terminals shipped and received 27.1 million twenty-foot equivalent units during 2007, which is equal to approximately one fifth of the total throughput of the

¹⁶³ Page 3, *Trade Facilitation Kit*, Singapore Customs, and *Singapore in Figures 2008*, Singapore Department of Statistics, 2008, and www.business.gov.sg/index.htm, July 23, 2008.

¹⁶⁴ Pages 1 and 2, *Singapore's Electricity and Gas Sector: the Competitive Market Moves Forward*, EMA, June 2004.

¹⁶⁵ www.ida.gov.sg, July 23, 2008.

¹⁶⁶ [www.lta.gov.sg/corp_info/doc/Road_Length\(km\).pdf](http://www.lta.gov.sg/corp_info/doc/Road_Length(km).pdf), July 23, 2008.

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world.¹⁶⁷ In addition, the Jurong Port offers multi-purpose and container capabilities on the north coast of Singapore.¹⁶⁸ As noted above, four of the FTZs in Singapore are located directly at or adjacent to these ports.

Rail Transport

During 2007, there was a total of approximately 138 kilometers of railway in Singapore, including Metro Rail Transit lines and Light Rail Transit lines.¹⁶⁹

Air Transport

Singapore's Changi Airport has won multiple awards and is considered among the best airports in the world. It has four passenger terminals, including a budget terminal, with an annual capacity in excess of 70 million passengers, and it offers regular service to more than 180 cities around the world. In addition, Changi Airport has nine air-freight terminals with an annual cargo capacity of three million tons. These terminals are supported by two express and courier centres and four buildings that house approximately 200 cargo agents. Singapore has one FTZ located at the Changi Airport.¹⁷⁰

Financial Sector

The corporations that operated within Singapore's FTZs during 2007 had access to a network of five local commercial banks and 106 foreign commercial banks.¹⁷¹ During that same year the financial sector in Singapore contributed 12 percent of the nominal Gross Domestic Product.¹⁷²

Business Sectors

Deloitte could not obtain reliable information on the specific business sectors that utilize the FTZs in Singapore. However, Table 9 below shows the number of active companies in Singapore during 2006.

¹⁶⁷ www.singaporepsa.com, July 23, 2008.

¹⁶⁸ www.jp.com.sg, July 23, 2008.

¹⁶⁹ [www.lta.gov.sg/corp_info/doc/Rail%20Length%20\(2007\).pdf](http://www.lta.gov.sg/corp_info/doc/Rail%20Length%20(2007).pdf), July 23, 2008.

¹⁷⁰ www.changiairport.com/changi/en/index.html?__locale=en, July 23, 2008.

¹⁷¹ Page 4, *Singapore in Brief 2008*, Ministry of Trade and Industry, 2008.

¹⁷² *Id.* at page 2.

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Table 9
Singapore
Formation of Companies and Businesses by Industry
2007¹⁷³

Industry	# of Companies
Manufacturing	9,238
Construction	8,445
Wholesale & Retail Trade	41,711
Transport & Storage	6,507
Hotels & Restaurants	4,601
Information & Communications	6,594
Real Estate, Rental & Leasing Activities	6,717
Financial & Insurance Activities	13,373
Professional, Scientific & Technical Activities	12,046
Administrative & Support Service Activities	4,924
Education, Health & Social Work	4,039
Arts, Entertainment, Recreation & Other Services	3,423
Others	447

Incentives

The incentives associated with operations within one of Singapore's FTZs are noted below.

- **Good & Services Tax ("GST") exemption** – Payment of GST is suspended on importation of goods to FTZs in Singapore, pending that such goods are supplied for transshipment or re-exportation to outside Singapore. GST is payable if the goods are supplied to the domestic market.¹⁷⁴
- **Customs & excise duties deferral** – Customs & excise duties are deferred on importation of goods to the FTZs.¹⁷⁵

¹⁷³ Page 3, *Companies & Businesses – Yearbook of Statistics Singapore*, Singapore Department of Statistics.

¹⁷⁴ *General Facilitation – Free Trade Zones*, Singapore Customs.

¹⁷⁵ www.business.gov.sg/EN/BusinessTopic/ImportExport/DepositingNStoringYourGoods/imp_ftz.htm, July 24, 2008.

- **Other Incentives** – Singapore Customs offers certain other incentives for facilitation of entrepôt trade within the FTZs, such as waived customs permits for eligible goods.¹⁷⁶

In addition to the incentives specifically applicable to FTZs, the Government of Singapore offers numerous other incentive schemes that are designed to attract and retain foreign business. These schemes, however, will not be discussed further in this report.

Business Inputs

Raw Materials

Raw materials for repacking, sorting and re-conditioning may be imported to Singapore's FTZs without GST and with customs & excise duties deferred.

Labour

Singapore's workforce was comprised of approximately 2.59 million individuals in 2006. Among these individuals 23 percent had a university degree, but, conversely, in excess of 500,000 people in the workforce did not have a secondary education. In addition, approximately 52 percent of Singapore's workforce was aged 40 or above during 2006.¹⁷⁷

Investors

Deloitte could not locate reliable information on the geographical origin of foreign investors that have established a presence in the Singapore's FTZs. However, Table 10 below shows the inward FDI in Singapore by industry during 2006, and Table 11 shows the FDI in Singapore by geographical region during that year.

¹⁷⁶ *Ibid.*

¹⁷⁷ *Report on Labour Force in Singapore 2006*, Ministry of Manpower, January 2007.

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Table 10
Singapore
Foreign Direct Investment by Industry
2006¹⁷⁸

Industry	SGD \$ Million
Manufacturing	109,125
Construction	1,054
Wholesale & Retail Trade, Hotels & Restaurants	62,195
Transport & Storage	19,231
Information & Communications	3,669
Financial & Insurance Services	130,153
Real Estate, Rental & Leasing	9,762
Professional & Technical, Administrative & Support Services	10,321
Others	364
Total	345,873

Table 11
Singapore
FDI by Geographical Region
2006¹⁷⁹

FDI by Origin	SGD \$ Million
U.K	52,621
U.S.	46,098
Japan	43,967
Netherlands	34,468
Switzerland	25,831
Malaysia	8,659

¹⁷⁸ Page 9, *Singapore in Figures 2008*, Singapore Department of Statistics, 2008.

¹⁷⁹ *Id.* at page 10.

The In-Bond (*Maquila*) Program in Mexico¹⁸⁰

General Description

Mexico's In-Bond (*Maquila*) program was established in 1965 and its primary aim at inception was to encourage foreign corporations to build factories along the U.S.-Mexico border¹⁸¹. Currently, In-Bond Corporations (*Maquiladoras*) may engage in a wide variety of business activities, but their common characteristic is that they all operate under the *maquila* regulations.¹⁸² These regulations allow for, among other things, temporary deferral and/or exemption of customs duties and VAT pending certain restrictions.¹⁸³

In 2004, there were on average 2,810 *maquiladora* plants established throughout Mexico that employed an average total of 1,115,230 individuals. During the same year, these plants generated approximately MXN 217 billion (approximately CAD \$22 billion) in value add for Mexico.¹⁸⁴

There appears to be no formal restriction on the geographical area in which a foreign corporation may establish a *Maquiladora*. Therefore, we believe that most of the descriptive factors in this section are equally applicable to all such plants. Accordingly, the continued discussion below shall not focus on a specific *maquiladora* plant unless the factual circumstances require otherwise.

Infrastructure

Energy

Due to a change in the legal framework during 1992, the electricity generation market is currently open for private participation. However, the government-owned *Comision Federal de Electricidad* ("CFE") was responsible for approximately two thirds of the Mexican electricity generation during 2005. In addition, CFE holds a monopoly on electricity transmission outside the Mexico City urban area and a few other municipalities. Most of Mexico's electricity generation comes from conventional thermal sources and in 2006 Mexico used approximately 735 trillion barrels Btu of natural gas.¹⁸⁵

The national transmission grid in Mexico is comprised of 43,000 Kilometers of high voltage lines, 45,000 kilometers of medium voltage lines and 595,000 kilometers of low voltage distribution lines.¹⁸⁶

¹⁸⁰ The *Maquila* program in Mexico is not the equivalent of a Foreign/Free Trade Zone. However, it is a scheme designed to attract FDI and increase manufacturing activities in Mexico. It was, therefore, jointly chosen by Deloitte and Client for further review.

¹⁸¹ *Free Trade in North America: The maquiladora Factor*, <http://dsp-psd.tpsgc.gc.ca/Collection-R/LoPBdP/BP/bp247-e.htm>, July 30, 2008.

¹⁸² *Ibid.*

¹⁸³ Page 43, *Basic Guide for Foreign Investors*, Mexican Bank for Foreign Trade, 2002.

¹⁸⁴ Page 32, *Mexico at a Glance*, Instituto Nacional de Estadística y Geografía, 2005.

¹⁸⁵ www.eia.doe.gov/emeu/cabs/Mexico/Electricity.html, July 30, 2008

¹⁸⁶ *Ibid.*

Telecommunications

Deloitte could not locate reliable public information on the development status of Mexico's telecommunications infrastructure. However, during 2004 Mexico had a low telephone density of approximately 17 percent. During that year Mexico had approximately 18,000 fixed telephone lines and 117,000 Kilometers of fiber optic networks.¹⁸⁷

Transportation

Road Transport

During 2004, Mexico had a total of 352,072 kilometers of roads, out of which approximately 34 percent were paved and the rest coated or rural.¹⁸⁸

Sea Transport

Mexico has in excess of 100 maritime ports with a total of 36,000 meters of docking facilities.¹⁸⁹

Rail Transport

During 2004, there was a total of approximately 26,662 kilometers of railway in Mexico, including 77.6 percent of main railway.¹⁹⁰

Air Transport

Mexico had 85 airports in 2004, which included 56 international airports and 29 domestic terminals.¹⁹¹

Financial Sector

Corporations that operated within the *maquila* program during 2007 had access to a network of 26 commercial banks, including a number of major international banks and local banks. As at December 2007, BBVA Bancomer had the highest market share of approximately 25 percent.¹⁹²

Business Sectors

Deloitte did not obtain recent reliable data for the business sectors that utilize the *maquila* program, but Table 12 below shows the share of value add by major industrial sectors relative to total value add during 1988. In addition, Table 13 below shows the FDI in Mexico by economic sector in 2004.

¹⁸⁷ Page 34, *Mexico at a Glance*, Instituto Nacional de Estadística y Geografía, 2005.

¹⁸⁸ *Id.* at page 35.

¹⁸⁹ www.investinmexico.com.mx/pied/cds/pied_bancomext/why_mexico/key_filename.htm#INFR, July 29, 2008.

¹⁹⁰ Page 35, *Mexico at a Glance*, Instituto Nacional de Estadística y Geografía, 2005.

¹⁹¹ *Ibid.*

¹⁹² Page 36, 2007 Annual Report, *Comision Nacional Bancaria y De Valores*, 2008.

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Table 12
Maquiladoras
Share of Value Add by Industrial Sector
1988¹⁹³

Industrial Sector	%
Electric and electronic goods	41.3
Transport equipment	25.5
Textiles and apparel	5.5
Wood and metal furniture	5.4
Food processing	1.0
Chemicals	0.8
Equipment and tools	0.2
Others	20.3

Table 13
Mexico
Foreign Direct Investment by Economic Sector
2004¹⁹⁴

Economic Sector	%
Manufacturing	52.2
Construction	0.7
Commerce	5.9
Transportation and communications	7.7
Financial services	29.5
Others	4.0

Incentives

The main incentives associated with operations within the *maquila* program are noted below.

¹⁹³ *Free Trade in North America: The maquiladora Factor*, <http://dsp-psd.tpsgc.gc.ca/Collection-R/LoPBdP/BP/bp247-e.htm>, July 30, 2008.

¹⁹⁴ Page 40, *Mexico at a Glance*, Instituto Nacional de Estadística y Geografía, 2005.

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- **Customs duties exemption and deferral** – Customs duties are exempt on goods imported for use by the *maquiladora* plants for subsequent exportation of the final goods. In the event the final products are destined for the local market, duties are deferred until such time.¹⁹⁵
- **VAT refund** – *Maquiladora* plants may receive a refund on VAT payments that have been made on goods for use in their production. The quantum of the refund is based on their ratio of export sales over total sales.¹⁹⁶

In addition to the incentives specifically applicable to the *maquila* program, the Government of Mexico offers numerous other incentive schemes that are designed to boost export sales and attract and retain foreign business. These schemes, however, will not be discussed further in this report.

Business Inputs

Raw Materials

Raw materials for use by a *maquiladora* plant may be imported without customs duties, Import Tax and VAT. Mexico is the world's largest silver producer and in 2003 its oil reserves were estimated at approximately 61,800 billion barrels.¹⁹⁷

Labour

Mexico's workforce was comprised of approximately 74 million individuals in 2005. These individuals were mostly male and employed in the services industry.¹⁹⁸

Investors

The Mexican *Maquiladora* plants are owned primarily by corporations in the U.S., but other geographical regions also have a presence including Japan, France, Canada and Korea.¹⁹⁹

¹⁹⁵ Page 43, *Basic Guide for Foreign Investors*, Mexican Bank for Foreign Trade, 2002.

¹⁹⁶ www.investinmexico.com.mx/pied/cds/pied_bancomext/legal_information/maquila_filename.htm, July 29, 2008.

¹⁹⁷ www.investinmexico.com.mx/pied/cds/pied_bancomext/why_mexico/key_filename.htm#NAT, July 30, 2008.

¹⁹⁸ Page 23, *Mexico at a Glance*, Instituto Nacional de Estadística y Geografía, 2005.

¹⁹⁹ *Free Trade in North America: The maquiladora Factor*, <http://dsp-psd.tpsgc.gc.ca/Collection-R/LoPBdP/BP/bp247-e.htm>, July 30, 2008.