

Do Economic Free Zones Pass Legal Scrutiny?

A Review on Existing and Emerging International Law on Foreign Direct Investment in Economic Free Zones

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“Do Economic Free Zones Pass Legal Scrutiny?” has been written as Master’s Thesis in International Law at Uppsala University, Department of Law, in Uppsala/Sweden. The author, Olle Pettersson, has worked before in the World Bank, Washington D.C. The views expressed in this paper are those of the author alone and do not necessarily represent the position of the World Bank.

This script has been finished in June 2003.

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INTRODUCTORY REMARKS

This thesis aims at clarifying public international law as related to the foreign direct investment (FDI) in economic free zones. The question is basically whether and to what extent the free zones are affected, or will be affected, by existing and possibly emerging public international law, not only under the World Trade Organization (WTO) regulations but in general. The premise may be stated in a very simple way: it is that public international law stemming from all kinds of sources, not only from the WTO covered agreements, affects free zones in a way that, for the future existence of some of them may be decisive. The title of the thesis is deliberately somewhat straight forward. If this paper will clarify anything, it is that no clear cut answer can be given to the question asked. Nevertheless, the question is the focal point of my analysis and in the lack of simple answers I will try to pinpoint the main concerns.

The thesis will begin by dealing with free zones in general, with public international law and with the relation between the two. Thereafter, I have chosen to address some of the most interesting legal aspects of this relation. The account is of course highly selective and each of the aspects requires deepened analysis. My paper will only briefly enumerate critical questions and possible solutions. The following questions are especially interesting. What is the content of international law as related to FDI in free zones? What will a future multilateral agreement on FDI look like and what implications would it have on free zones? How are free zones affected by the WTO Agreements?

How are free zones affected by international law as regards discrimination and the principles of the most-favoured nation and national treatment?

At the outset, I would like to stress that the paper will be limited in its scope to a certain number of chosen questions as the issue at hand involves a very large spectrum of legal aspects. The focal point is the commercial presence of foreign direct investors in economic free zones as defined below vis-à-vis international law. The legal aspects of the conduct of the foreign investors will not be subject to the present study. Nor will there be any discussion on the law on expropriation or nationalization as this is a subject that often has been analyzed in the legal doctrine.¹ The ambition of this paper is instead to give the general picture of the substantive content of the international legal framework on FDI as related to free zones. An exhaustive and all-encompassing description of the current situation is impossible to deliver in this context as the normative framework is not only incomplete, but also under constant change. Furthermore, free zones are affecting a range of different areas of law, involving international labour and environment standards, which are not dealt with here. There has always been a great debate on the pros and cons of economic free zones. Some economists have stressed their advantages,² some labour organizations have uttered concerns on labour standards³ and there has been criticism of multinational corporations' (MNCs) behaviour within zones. As the present work addresses the strictly legal issues related to the interaction of international law on FDI in the free zones, the former, although very interesting areas will be put aside.

In the first part, free zones, their background and features, will be outlined in brief. In the second part, I will assert the importance of public international law in this field of law. I want to illustrate that even though free zones are creations of national legislation they are by no means unreachable to international legal principles. These principles will be the subject for the analysis in the third part aiming at defining their content as it is at present, i.e. *de lege lata*. The principles will primarily concern FDI in general. The fourth part involves a scrutiny *de lege ferenda* of possibly emerging law, and a survey of potential legal problems of free zones. I conclude with some suggestions of suitable measures.

The presentation at hand will be characterized by the fact that free zones seldom are subject for legal scrutiny, whereas investment law in general, has been discussed at length. Accordingly, the law that could be relevant to free zone operations is either part of the general corpus of international investment law or is relevant to the specifics of zones solely. For this reason the review will deal, to a great extent, with international law regarding FDI at large as in the presentation *de lege lata* in Part III which is heavily dominated by general investment law. As regards the argumentation *de lege ferenda* in Part IV, the analysis will concern international law that directly affects zone programs.

¹ Furthermore, expropriations are becoming increasingly rare. Shihata in World Bank Guidelines, p. 195 and Graham, p. 3-6.

² The benefits of economic free zones to the host state are however not undisputed. See e.g. Warr who argues that free zones at best have a very limited positive impact on the host country. Warr, p. 65 *et seq.* Hamilton and Svensson and Hamada and Miyagiwa go further and assert that free zones are generally welfare-reducing. Hamilton and Svensson, p. 45 *et seq.*, Hamada, p. 225 *et seq.* and Miyagiwa p. 337 *et seq.* Cf. Drucker who claims that “[t]o create wealth, jobs and incomes in desperately poor countries, it (an economic free zone) is the only poverty program that works”. WEPZA website under Editorial. Cf. also English and De Wulf who argues that “[free zones] are second-best solution compared with generalized economywide reforms, but where countrywide reforms are difficult to implement, they can be a useful instrument in the development arsenal of governments confronting large reform agendas”. English and De Wulf, p. 166. Few cost and benefit studies have been made on free zones.

³ E.g. various ILO publications. There is also fairly a large amount of Nongovernmental Organizations (NGOs) expressing criticism on the internet, e.g. the Transnational Corporations Observatory and Global Policy Forum.

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