Free Trade Zones in Ireland and Four Asian Countries

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In this article Eoin O'Malley of the Economic and Social Research Institute argues that multinational investment in free trade zones makes a very limited contribution to the economic development of a number of Asian countries and may not justify the costs to the host government in terms of incentives, infrastructure and exploitation of workers. It is a matter of serious concern, he suggests, that the World Bank and the IMF are pressing less developed countries to set up free trade zones.

In the 1950s, the world's first industrial free trade zone (FTZ), or export processing zone, (EPZ) was established at Shannon Airport. This experiment attracted a good deal of international interest and the results were regarded as a considerable success by UNIDO and other international agencies which urged developing countries to imitate the Shannon project. Since then some fifty countries have opened their own industrial FTZs and today well over one hundred of them ring the globe in Asia, Africa, and Latin America. In many less developed countries (LDCs) these zones are held to be a key element in their strategy for industrial and economic development.

This article very briefly presents some of the findings of a major research project on the economic and human consequences of FTZs in Taiwan, the Philippines, Malaysia, Sri Lanka and Ireland. The research was carried out in each country under the umbrella of the Asia Partnership for Human Development, a federation of twenty-one Roman Catholic development agencies from Asia, Europe, Australasia and North America. Trócaire took responsibility for the Irish study. A book containing the findings in considerably greater detail is due to be published shortly.[1]

The FTZ concept

Essentially, a free trade zone is an enclave within a country into which goods may be imported or from which they may be exported free of taxes, duties and often at least some of the regulations applying elsewhere in the country. Free ports or zones, for the purpose of facilitating trade, are by no means new, but the concept pioneered by Shannon was the development of an industrial estate within such a zone with factories and infrastructure provided for the convenience of the companies involved. Thus, even in a country which normally imposes substantial taxes or duties on imports or exports, as in Ireland in the 1950s or many developing countries today, it is possible for industrial firms within such a free trade enclave to import material inputs and capital equipment and to export their products freely. The main attraction of FTZs is thus for highly export-oriented firms which import many of their inputs.

Apart from the free trade aspect, other inducements to investment in FTZs often include profit tax concessions and government grants. In developing countries, further inducements include very low wages, waiving of health or safety regulations and limitations on workers' rights to organise unions. It is this latter aspect, concerning the conditions and rights of workers, that raises the question of social justice and the human consequences of FTZs, particularly since most of the companies operating in them are branches of wealthy multinational corporations producing goods for affluent markets and making profits for shareholders in those countries.

FTZs and industrialisation strategy

Most of the ex-colonies which gained independence in the twentieth century, including the five case studies referred to here, initially attempted to industrialise by import-substitution. Their first instinct was to erect protective barriers against imports behind which they hoped local industries would develop, sheltered from competition from advanced industrial countries. Ireland, which then had very little industry, adopted this strategy in the early 1930s, as did some of the major Latin American countries which were also independent at the time, and the real but limited gains which initially resulted made it seem an attractive approach in the post-War period for new states seeking an economic model. As they gained independence, Taiwan and Sri Lanka adopted protection in the late 1940s and the Philippines and Malaysia did so in the 1950s.

It gradually emerged, however, that there was an initial 'easy' phase of import-substitution during which growth occurred mainly in consumer goods industries with relatively low technological and skill requirements. Progressing further into more technologically demanding and skill-intensive industries, particularly in capital goods, proved to be slower and much more difficult. In addition, most of the protected industries which did develop remained uncompetitive in international terms so that Ireland, like the Latin American countries, still exported little of its industrial output by the 1950s. In these circumstances, stagnation eventually set in as the scope for 'easy' import-substitution was exhausted and export development failed to occur. By the early 1950s, as the new Asian states were moving into import-substitution, Ireland's industrialisation was already grinding to a halt. Taiwan made progress for a longer period, largely attributable to massive US aid amounting to over half of Taiwan's investment in the 1950s. But Sri Lanka, the Philippines and Malaysia experienced more or less chronic problems with the strategy after having some success in the initial 'easy' phase.

In response to the limitations of protectionist import-substitution, many developing countries, often under pressure from the IMF or World Bank, began to shift, to varying degrees, towards a more 'outward-looking' or export-oriented style of industrialisation. This change began in Ireland in the 1950s, followed later by Taiwan and then the Philippines, Malaysia and Sri Lanka. When implemented in its fullest sense, this strategy, which is now the strategy conventionally recommended by international bodies such as the World Bank, involves: (a) the dismantling of protection, moving to free international trade; (b) emphasis on export development rather than import substitution; and (c) an open door for investment by foreign multinational companies. In addition, although the state may offer general incentives such as investment grants and tax concessions, in the orthodox version of this strategy the state would rely on private enterprise and initiative rather than becoming actively involved in selecting particular industries for development and intervening directly to promote them.

Of the five countries, Ireland has adopted this strategy to the fullest extent since free trade with European countries was introduced under the Anglo-Irish Free Trade Agreement of 1965 and by accession to EEC membership in 1973. The other countries still retained elements of protection, although they were generally less restrictive than previously, but they have moved to attract foreign investment and to promote exports. In Taiwan, in particular, a further divergence from the orthodox approach is substantial direct state intervention to develop target industries, including considerable reliance on state enterprises in the modern large-scale sectors.[2]

Despite the variations in policy, all countries have a common programme to promote industrial exports and to attract investment by foreign multinational companies for that purpose. Industrial FTZs play a part in this effort by providing an attractive business environment free from the restrictions imposed by protection. Where protection is in operation, the zones are more attractive for many export-oriented firms than the rest of the country. The Shannon FTZ provided a unique environment within Ireland when it was established in the late 1950s, although the particular attraction of Shannon faded as Ireland's protection was dismantled, making the whole country akin to an FTZ. Taiwan opened its first FTZ in 1966 and two more in the early 1970s. The other countries started later, with Malaysia opening ten zones between 1970 and 1977, while the Bataan zone in the Philippines began operations in 1972 with two more following in the late 1970s. Sri Lanka opened its first FTZ in 1978.

Economic impact of the FTZs

The experience of export-oriented industrialisation and FTZs in Ireland, Taiwan, Malaysia, the Philippines and Sri Lanka is very diverse, but at the same time the diversity suggests a general pattern of economic results. Ireland and Taiwan enjoyed certain advantages in attracting multinational firms which were probably not repeatable by most LDCs opening zones more recently, and accordingly they had more favourable results than the other three countries. At first, their advantage was partly just a matter of being among the first to actively seek out and offer incentives for foreign investment in export-oriented industries, so that they did not have to compete with a host of low-wage countries. Ireland could attract foreign firms offering wages and working conditions which were very good by LDC standards, and Taiwan was able to impose fairly stringent conditions on foreign investors, insisting on a minimum amount of value-added within the country.

Their "first-comer" advantage faded as time went on, but Ireland still had advantages over most low-wage LDCs in the form of political stability, a European location with guaranteed access to the UK market and later the EEC, relatively good infrastructure, skills and education, and a culture relatively familiar to American and European managers. So foreign firms paying high wages by LDC standards continued to invest in Ireland at a rate greatly disproportionate to the country's size. Taiwan, too, has had special advantages for attracting multinational firms, particularly in political stability (very different to Ireland in form, but still favourable to private capital) and a special strategic relationship with the USA which meant favoured access to US markets and a strong sense of security for investors.

For most LDCs without such special attractions the problem is that the available pool of mobile foreign investment is much too small to go round. If they are to get a significant share they are obliged to offer increasingly generous (and costly) incentives, to provide factories and infrastructure, perhaps to waive the application of laws and regulations, to keep labour costs very low and to provide a docile or repressed labour force. The economic consequences of this intense competition for foreign investment can be that there is little or no return on the host country's investment – the costs can be as great as the benefits. The social or human costs can also be substantial, a point discussed below.

To concentrate on the economic consequences of FTZs for the moment: a major aim of the zones was to boost exports and increase foreign exchange earnings. But rising exports would not in themselves represent significant economic progress if imports of material inputs were also rising rapidly, meaning that little of the value of production and export receipts was being retained in the host country. For the FTZs in the five countries, the net gain of exports over imports was as shown in Table 1.

Table 1: **International Trade Transactions of FTZs**

Country	**Imports as % of Exports**	**Trade Surplus as % of Exports**
Ireland (1981)	40.5	59.5
Taiwan (1985)	53.3	46.7
Philippines (1973-82)	77.3	22.7
Sri Lanka (1979-81)	79.0	21.0
Malaysia (1979)	94.7	5.3

Source: See Footnote 1.

It can be seen that the net contribution of the zones to domestic production and foreign exchange earnings, after deducting the value of imported inputs, is far less than the value of exports, particularly in the three late comers – the Philippines, Sri Lanka and Malaysia. In these countries, not only are most material requirements imported, but value-added is also very low, meaning that the wealth created and retained in the country is only a small fraction of the value of total output.

A basic problem here is that the main way in which wealth is retained in the host country is through the payment of wages to the workforce since little of the material input requirements are sourced locally, government taxes on the firms involved are small or negligible and profits of the multinationals tend to be repatriated eventually. If wages have to be held at very low levels in order to attract the multinationals in the first place, their net contribution to the economy and foreign exchange earnings must be correspondingly small. The main reason why the proportion of wealth retained in the host country is so low in Malaysia, Sri Lanka and the Philippines, as compared with the higher levels in Taiwan and Ireland, is because wage levels are lower in the three latecomers than in Taiwan and much lower than in Ireland.

This problem raises a fundamental question about the FTZ policy in countries such as Malaysia, Sri Lanka and the Philippines which do not have the special attractions for multinationals of Ireland and Taiwan. Wages in such countries have to be held very low in order to attract foreign investment but low wages mean that there is relatively little benefit to the host country. So do the benefits justify the costs at all? In some cases at least, it seems they do not. A study of the Bataan FTZ in the Philippines concluded that, taking account of all benefits to the economy, there was a negative rate of return of -3 per cent a year on the government's investment in infrastructure and other costs. Net foreign exchange earnings of the zone were 85.5 million pesos in 1982, an insignificant amount for a project that had cost 3,790 million pesos in infrastructure, administrative costs and subsidies by that year.[3] It remains to be seen whether this will also be the fate of the Sri Lankan and Malaysian zones but it seems possible (see Table 1).

Employment

Another major aim of the FTZs has been to create jobs, and employment figures for the zones in the five countries are shown in Table 2.

Table 2: **Employment in FTZs in Five Countries**

Country	**Employment**	**Per cent of Manufacturing Workforce**	**Per cent of Total Workforce**
Taiwan (1985)	76,900	3.1	1.0
Malaysia (1982)	70,900	11.0	1.6
Philippines (1982)	25,600	1.2	0.1
Sri Lanka (1981)	17,800	2.7	0.3
Ireland (1983)	4,300	1.9	0.3

Source: See Footnote 1.

Although the absolute employment figures may look substantial, they represent only small fractions of either the industrial or total workforce in each country. Nor does this understate the general importance of FTZs in developing countries since Taiwan has more employment in FTZs than any other country and Malaysia has the second highest number in the world. Thus, even in these countries, the employment impact is really quite small in relation to other industries or the total workforce, and it could not be regarded as a major contribution to industrial transformation. In addition, employment in FTZs in the five countries has been declining.

There are, of course, other export-oriented multinational companies outside the zones, particularly in Ireland where those outside Shannon are now far more important. But even taking account of all such foreign investment, the impact is still very small in relation to the size of the economy and labour force of these countries except in Ireland, and this is true of developing countries in general. There simply is not sufficient mobile foreign manufacturing investment available to bring about significant industrial development in most LDCs, so that relying on foreign firms for a major contribution to industrialisation is scarcely realistic for most of them.

Multinationals tend to have strong preferences for certain countries, depending on factors such as political "reliability", location and access to large markets, so that they are disproportionately concentrated in certain places. For example, about 80 per cent of the 450,000 jobs in Asia's FTZs in 1978 were in Taiwan, South Korea, Hong Kong and Singapore. The stock of US manufacturing investment in Ireland was equivalent to 5 per cent of that in all developing countries although Ireland's population amounted to only about 0.1 per cent of LDCs.[4] Where such a disproportionate concentration occurs in a very small country like Ireland or Singapore, there can be a significant impact on the economy, so that foreign-owned multinationals in Ireland, for example, now account for close to 40 per cent of manufacturing employment and about three-quarters of manufactured exports.

Such results must be regarded as exceptional and cannot justify the prevailing orthodox recommendation for LDCs in general of outward-looking policies, with a major role for multinational companies, nor the pressure imposed on many countries by the international financial organisations to adopt such policies.

Lessons for industrial strategy

To conclude on the economic aspects of the study, the five country case studies suggest a number of conclusions for industrial strategy in LDCs. First, as mentioned above, most countries cannot expect a really major contribution to overall economic growth and employment from foreign export-oriented industries. Special advantages in attracting foreign investment combined with a small size seem to be necessary for this to occur. In countries which do not seem particularly attractive to multinationals, there is a risk that any benefits from schemes to encourage their investment may not justify the costs, and there are likely to be better ways for a government to invest its money.

Second, looking at Ireland, which went furthest in adopting the full free trade, free market approach, there seem to be serious risks in abandoning protection in a relatively weak late-developing economy. Ireland did experience fairly strong industrial growth under free trade in the 1960s and 1970s, but this was due to new foreign investment on a scale which most countries could not expect. Formerly protected, native Irish-owned firms lost ground steadily to competing imports once the dismantling of protection began, so that their employment stopped growing in the mid-1960s and Irish-owned firms now employ considerably less people than they did then. This is the experience of only one country, of course, but there are actually few examples of other late-industrialising countries with free trade policies from which to draw lessons, and the international trade performance of native-owned industries in these other countries, such as Singapore or Puerto Rico, does not inspire confidence.[5]

While protection alone may not provide a satisfactory solution to the problem of industrialisation in LDCs, the full free trade, free market approach is likely to be a very risky alternative for many of them.

Third, if LDCs are to industrialise successfully, most of them will have do so mainly by building up their own native-owned industries. Even in Ireland, where foreign multinationals have made proportionately the greatest contribution to industrialisation among the five countries, it has now been officially recognised in the White Paper on Industrial Policy (1984) that future progress must depend far more on native-owned industries, because competition for a declining volume of mobile (multinational) investment is constantly intensifying from both industrialised and developing countries.

Whereas Ireland has been presented at times as a model of one type of industrialisation strategy, depending on much foreign investment, it clearly does not have a great deal to teach the world about development of competitive native industries. Of the five countries, Taiwan has had most success in this area, with industrial growth rates among the highest in the world coming principally from native industries. Taiwan's strategy (as in South Korea, and Japan at an earlier stage) involved selecting priority or target industries for development, protecting them at first while actively nursing them to competitive maturity, and then breaking into export markets. More than just protection, it involved active and selective state intervention, with a good deal of direct state investment. There may be something to learn here.

Finally, it should be acknowledged that these conclusions are open to dispute, and many would not agree with them. But, at the least, it must also be admitted that the evidence in favour of the conventionally recommended outward-looking, free market strategy, relying heavily on foreign investment, is questionable and less than conclusive. In these circumstances, it is a matter of serious concern that international financial agencies should be pressing LDCs so hard to adopt such policies, often against the judgement of many people in the LDCs, so that, in the Philippines for example, major political crises have revolved around such issues of economic and industrial policy. Concern about this external pressure is increased by the fact that the agencies in question are controlled by the large developed countries, particularly the USA, whose major corporations have an obvious vested interest in opening up the LDCs for their activities.

Workers and their conditions

A full assessment of the impact of FTZs should go beyond an economic analysis and look at the social impact, and accordingly the study of FTZs in five countries on which this article is based included surveys of workers in the zones. These surveys found major differences in the composition, conditions and attitudes of the zone workforce in Ireland, and to a lesser extent in Taiwan, compared with the other countries. Table 3 shows some basic data on the workers.

Table 3: **A Profile of FTZ Workers, early 1980s**

	Ireland	**Taiwan**	**Malaysia**	**Philippines**	**Sri Lanka**
24 years or younger	36%	59%	77%	78%	81%
Female	27%	83%	83%	87%	85%
Single	n.a.	n.a.	96%	79%	91%
Rural	n.a.	54%	83%	97%	67%
Daily Wage (US$)	$21*	$9.1	$2.1	$2.6	$0.9

Source: See Footnote 1.
*Basic wage rate for lowest paid assembly workers in 1982

A striking feature of the table is the extent to which the zone workforce in Malaysia, the Philippines and Sri Lanka is composed of young, single women from rural backgrounds, and in each of these countries this is quite different from the composition of the broader industrial labour force. Rates of pay are also very low, below the poverty line in Malaysia and the Philippines, and although official minimum wage rates are observed in Sri Lanka, wages there are even lower, the minimum rate being calculated as no more than enough to provide for a worker's most basic needs. In Taiwan, too, a very high proportion of the FTZ workforce are women, also younger and tending more to come from rural areas than in the rest of the country, although these aspects are less marked than in the other three countries. Wage rates in Taiwanese zones are considerably higher than in the other three Asian countries, but are nevertheless below the national average.

Only in Ireland does the general profile of the FTZ workforce correspond quite closely to that of the industrial sector in general, with wages and conditions also being comparable to the situation outside the zone, if not better in some respects. The survey of Shannon workers found most of them to be broadly satisfied with their employment, apart from a prevailing concern with long-term job security given the unemployment situation.

The situation of workers in the Asian zones is thus very different, and the country case studies suggest why this new proletariat of young, single, rural women has been particularly sought out by multinational companies there. Foreign firms investing in Ireland see a variety of attractions in doing so, especially ease of access to major European markets and, by comparison with alternative European locations, favourable tax concessions and grants, as well as relatively low wages by European standards. But they are not primarily attracted to Ireland by low labour costs and, indeed, if that was their main requirement they would go elsewhere in the world. Those investing in the Asian FTZs, on the other hand, are primarily seeking low-cost labour for unskilled labour-intensive production processes. Thus, they mostly employ young, single women because in each country their wage rates are lowest. Such workers are also considered more compliant, easier to discipline, more patient doing repetitive tasks and easier to dispose of than an older, predominantly male workforce, perhaps particularly with rural women who are new to industrial employment. In all respects labour costs are lowest with such workers.

The composition of the workforce in the Asian FTZs reflects the primary importance of the lowest possible labour costs in attracting foreign investment. Rising wages and agitation by workers for better conditions might scare away mobile multinational operations and so, in order to support an industrialisation strategy identified as central to economic growth, governments have acted to ensure that labour costs do not rise and workers do not challenge their employers. In the four Asian countries, zone workers were strongly discouraged or prohibited from forming workers' associations or joining unions, and this suppression or tight control of workers' organisations has in some cases carried over into general labour controls outside the zones.

Such suppression of workers' organisations is not peculiar to LDCs with an export-oriented strategy or FTZs. But there does seem to be a certain inexorable logic in it in such countries, given that the strategy depends quite fundamentally on offering cheap and tractable labour in order to attract highly mobile multinational companies which are free to choose from a wide range of possible locations. Governments in these countries are drawn into the paradoxical situation of suppressing groups of workers in their own population in the name of economic progress and development, despite the fact that the main benefit for their economies from foreign investment comes through the payment of wages. This situation results from the intensity of competition among so many LDCs in trying to attract foreign investment, so that the clearest beneficiaries are ultimately the multinational investors, and in some cases – indirectly – local employers.

The dissatisfaction of the workers themselves has been most evident in the Bataan FTZ in the Philippines where most of the workforce has unionised and strikes have occurred, despite the legal controls and deployment of the security forces within the zone. Even in Taiwan, where wage rates were much the highest of the four Asian countries, the researchers found evidence of considerable dissatisfaction. Although their survey collected generally positive responses to direct questions about working and living conditions in the zones, this could well be largely a reflection of the generally conformist and highly controlled cultural system. There was a high rate of employee turnover, with about 5 to 10 per cent of women workers quitting every month, while the young women employed in the zones commonly regard themselves as "students" temporarily employed to support their further education.

The Taiwanese study, in particular, exposed the psychological stress experienced by workers enclosed in an alien and unnatural environment. Indeed, the Asian studies in general highlighted the social and cultural dislocation experienced by young rural women drawn into this form of industrial employment. Living conditions, often in cramped dormitory accommodation, can be almost as stressful as working conditions.

Assessment

To conclude, how is one to assess the general benefit or value of foreign investment and the FTZ strategy in promoting the material and social welfare of the people in LDCs? One clear lesson from this set of comparative case studies is that the answer depends on a country's circumstances. The Irish case showed that the strategy can produce some quite positive results in a country with particular attractions for multinationals, even though this alone is insufficient to promote adequately the country's overall economic development. It is also clear, however, that in larger countries with no particularly strong attractions for foreign investors, the contribution of FTZs and multinational investment to economic development is very limited and may not even justify the costs to the government of the host country.

The pay, conditions and limitations of rights of workers in FTZs in such countries represent further objections to this strategy. It might be argued, however, that industrialisation is inevitably a painful process initially and that the workers of the Third World must endure social disruption and economic sacrifices similar to those borne by the working classes of industrialising Europe in the nineteenth century. In response to this, it is worth pointing out that Europe's industrialisation in the last century involved the accumulation of capital, skills and technology which eventually laid the foundations for far more prosperous societies. But in the Asian FTZs the unskilled, labour-intensive operations of foreign multinational companies, who develop and control the technology and receive the profits, promise no comparable long-term benefits for the host countries.

Furthermore, in retrospect, most Europeans would regard the conditions of workers in the early Industrial Revolution as deplorable and unjust, and there are similar grounds for concern now about the situation of many industrial workers in LDCs. It should be remembered that the exploitation of cheap labour convinced European workers of the need to organise and struggle for a more equitable place in their societies, and if that could be regarded as a legitimate objective the same applies now to those in the LDCs who are struggling for similar aims.

It might also be argued that the conditions of workers in the Asian FTZs at least represents an improvement on the rural poverty which is widespread in most of these countries, since the workers themselves have chosen to move from rural areas to work in the zones. This may be so, but rather than simply establishing that the FTZs represent real progress, it should draw attention to the causes of the apparently even more intolerable situation of many in the rural areas.

The Sri Lankan study looked at the conditions which pushed young rural women into the zone workforce, finding that the great majority of farm families work less than five acres, while there is considerable inequality in the pattern of land ownership.

The fact that zone workers might choose their employment in preference to living in conditions of deprivation in rural areas gives little cause to applaud the "progress" and opportunities presented by the FTZ. Real progress would be represented by reform in the rural areas so that people would not be attracted by such very low-paid employment. In Taiwan, for example, where a comprehensive land reform was carried out several decades ago, it is highly unlikely that people with an adequate living in rural areas would enter industrial employment for the sort of wages paid in the FTZs of the other three Asian countries.

Finally, it is evident from the five case studies that much of the exploitation of workers in the poorer countries results from competition between countries trying to attract a share of the relatively scarce amount of mobile multinational investment, and from competition between workers for the resulting employment. Competition and division between countries and workers keep wages very low and limit workers' freedoms. This is an international problem requiring an international response.

Footnotes

[1]Dennis Shoesmith (editor), *Export Processing Zones in Five Countries: the Economic and Human Consequences*, Asia Partnership for Human Development, Hong Kong (forthcoming). This article draws heavily on this study for information and some conclusions, summarising selected parts of it, although Dennis Shoesmith is not necessarily responsible for any views expressed here.

[2]See Robert Wade, *"Dirigisme Taiwan-Style"*, IDS Bulletin, Sussex, Vol. 15, No. 2, April 1984.

[3]Peter G. Warr, *"Export Promotion via Industrial Enclaves: The Philippines' Bataan Export Zone"*, Australian National University, 1984.

[4]Shoesmith, op cit., and US Department of Commerce, *Survey of Current Business*, October 1981.

[5]See Hock Beng Cheah, *"Export-Oriented Industrialisation and Dependent Development: the Experience of Singapore"*, IDS Bulletin, Sussex, Vol. 12, No. 1, December 1980; and Jose J. Villamil, *"Puerto Rico, 1948-1976 – The Limits of Dependent Growth"*, in Jose J. Villamil (editor), *Transnational Capitalism and National Deoelopment* Harvester Press, Hassocks, 1979.