

# The Implications of Successful SEZs in Northeast Asia: Opportunities for Developing SEZs in Mongolia

Tsolmon Tsagaach\*

## Abstract

*Mongolia has been trying to develop several types of Special Economic Zones (SEZs) after it passed “The Law on Free Trade Zones” in 2002. Unfortunately, these efforts haven’t been fruitful so far. As of today, there are three state-supported Free Trade Zones (FTZs), which are being promoted unsuccessfully by the government of Mongolia. The Zamyn Uud FEZ is located at the biggest trade port between Mongolia and China, while on the other hand, the Altanbulag FTZ is located on the northern border of Mongolia and is the main port for entering Russia. The other FTZ, Tsagaannuur, is located at the crossroads of four countries: China, Kazakhstan, Mongolia and Russia.*

*In this paper, we will analyze the policies and lessons from the countries that have benefited from successful FTZs. Then we will compare them by certain criteria and will try to find a suitable mode that can enable and push the development of Mongolia’s SEZs. Also in this paper we will examine the dark side of the so-called “isolated enclaves” and will identify certain causes for unsuccessful or unbeneficial SEZs, so that Mongolian SEZs can avoid them.*

Keywords: Special Economic Zone (SEZ), Free Economic Zone (FEZ), Free Trade Zone (FTZ), benefit for local economy, FTZs of Mongolia, new concepts in SEZ development

JEL classification code: K33

## 1. Introduction

In the global context, SEZs are entering the next stage of development throughout the world. SEZ concepts are changing in regard to their rapid expansion in developing countries. For a long time SEZs have been isolated enclaves and have been criticized for being less beneficial to local economies.

However, recent developments in SEZs are signalling a different tone in that aspect. China launched its latest SEZ in Shanghai as a “pilot SEZ” to test a new policy toward changing the traditional concept of “no benefit to local economy FTZs”. Malaysia even downgraded the success of the Penang Export Processing Zones (EPZs) because they haven’t been beneficial in other areas except employment generation. India has started changing regulatory procedures within the SEZs in favor of the long-term benefit of the local economy. Even Russia has begun taking some initiatives in the establishment of newly defined SEZs, and they are planning to establish a border FTZ right next to Altanbulag FTZ.

Where do we fit within these new, changing forms? Do we need to improvise and get in line with these new policies or should we take advantage of the niche that has been opened after other countries are shifting to the new horizon?

In Northeast Asia, the country that has great experience in SEZs is China. Therefore, first we will look into the success and failure stories of Chinese SEZs and then we will discuss the preferential policies of Korean SEZs.

According to the World Bank, in 2014 there were 6 SEZs, 14 open coastal cities, 4 pilot

free trade areas and 5 financial reform pilot areas in China. There were also 31 bonded areas, 114 national high-tech development parks, 164 national agricultural technology parks, 85 national eco-industrial parks, 55 national ecological civilization demonstration areas, and 283 national modern agriculture demonstration areas.

## 2. What Did They Do to Attract FDI and MNCs to the SEZs?

To demonstrate this in more detail we will focus on the case of the Shenzhen SEZ, which is regarded as the most successful SEZ in China in many studies. One could argue that there are more reasons than we illustrate here to the success of Chinese SEZs; we list those success factors below:

***Flexibility of SEZ policies and autonomy of local government of SEZs.*** The central government of China granted Shenzhen municipality the right to make its own local rules and policies in response to the needs of the investors and multi-national corporations (MNCs). This enabled the Shenzhen authorities to act according to their planned strategy and they issued several important policies and regulations (300 enacted laws, 70% of which were related to opening up and the market economy) that put them above the competing SEZs from other areas of China (Shenzhen Planning Bureau, 2001). One example is that they allowed investors in high-tech sectors to sell their products on the local Chinese market for the first time in the history of Chinese SEZs.

***Timely transformation into reform.*** Shenzhen was the first SEZ which announced no more labor-intensive investments to the existing and potential investors of the zone (Wang, 2003). It was one of the top FDI destinations in the 1980s, since it was one of the few zones which were protected by special grants from the government to openly attract investments in certain sectors, especially in labor-intensive ones. However, the early 1990s indicated the disadvantages in this approach due to strong competition from other SEZs in China to host MNCs in labor-intensive industries. Therefore, Shenzhen defined a new strategy of establishing itself as a modern, world class SEZ in high-tech industries with the latest urban infrastructure. To reach this goal the authorities in the zone didn't approve any labor-intensive projects and introduced new regulations that drove out many former factories (except pollution-free companies) to non-SEZ zones such as Liantang. Seeing SEZs as experimental laboratories for developing and putting new policies into effect, central government not only avoided the potential disruption in the economic, social and political spheres, but also has been able to identify problems, sort out issues, develop measures, and test and evaluate results (Ge, 1999).

***Effective involvement of the government.*** In the case of the various Chinese clusters the government has been relatively effective in building infrastructure, creating market places, and establishing technology innovation platforms and R&D centers. Moreover, the government was willing to let the SEZ authorities create their own business environment to attract investors without intervention from the government. For Shenzhen SEZ, due to its favorable business legislation and high quality infrastructure, leading MNCs like IBM, Seagate, Compaq, Olympus, Sanyo and Lucent have their production facilities in Shenzhen, making Shenzhen one of the top three hi-tech zones among China's 52 hi-tech zones (Wang, 2003).

***FDI attraction.*** Lack of capital and technology in the early periods of SEZ development made the Chinese government desperately seek FDI from MNCs. It offered generous financial

incentives (some argued it was too generous) to the investors in the SEZs. Incentives successfully attracted FDI (especially in port-cities) and has become an important source of capital, skills, technology, and modern management techniques. For Shenzhen, besides the low tax rates there were several additional preferences for investors in the zone. For instance:

- Exemption from income tax for the first two years then a 50% reduction for the next eight years;
- Export-oriented, newly established entities would be spared half of the fee for land use. If the business was in the high-tech industry there would be no fee for land use;
- High-tech enterprises were free from property tax for five years. Other projects were exempted from property tax for three years;
- High tech companies which were run by foreign investors (including Macao, Taiwan and Hong Kong) could be registered as domestically-funded if the share of the foreign capital in the total investment was not higher than 25%.

***Public-private partnership approach.*** In the developing stage of SEZs the government can partner with private companies in financing the project and building infrastructure. For Shenzhen, some part of the basic infrastructure was built by private developers and joint ventures from Hong Kong (Yeung, Lee, and Kee, 2009). In the Puyuan sweater cluster in Zhejiang, the local government formed a shareholding company with 27 private logistics and transport firms to build the cluster's logistics center (Ruan and Zhang, 2008). In the technology innovation center in Guangdong, public institutions and private firms joined forces to conduct R&D.

***Innovation, adaptation, and learning.*** Rising competition to attract investment in labor-intensive, low-cost industries made the government realize the importance of innovation and technological know-how for the competitiveness of SEZs. Thus the government started investing more in R&D infrastructure, knowledge sharing, and offering more favorable incentives to high-tech investors. For Shenzhen, it was obvious that high-tech companies in the zone were transferring very little technological know-how to their Chinese partners. Therefore the SEZ authorities took some measures to fix this issue, and one was to offer preferential access to domestic high-tech companies if they wanted to enter the zone. As a result, not only did a number of domestic high-tech firms enter Shenzhen from other parts of China, but also the most prestigious universities, such as Peking University, Tsinghua University, Harbin University of Science and Technology and Central China University of Science and Technology, established their research institutions in the zone (Shi, 2002). On the other hand the local authorities of the zones and industrial associations have been offering managerial and technical training to the workers of the zone using a large budget from the government.

***Realistic objectives, good benchmarking and local competition.*** Chinese SEZs have their own clear objectives, plans, expected GDP growth, employment, export, FDI and even tax revenue. These results are under the strict annual monitoring of the central government. One interesting aspect of the SEZs in China is that they compete vigorously with one another to benefit from the reward system of the central government. The local authorities of the SEZs have great responsibility to sustain or increase their competitiveness in comparison with other competing zones (Zeng, 2011). Even clusters rival each other in terms of the level of GDP growth reached, despite the lack of precise development plans for the clusters. In recent years, the focus of the competition has shifted to being "green" and contributing to social development.

Now we can discuss some successful examples of preferential policies implemented by the Korean SEZs. Masan Free Trade Zone, the most successful zone among the eight Korean SEZs, was established in 1970 and initially was a prototypical export processing zone. The objective of Masan FTZ was to support the development of manufacturing activities that complemented those of the Korean economy but did not compete with them. For this reason, the zone was relatively small (90 hectares) compared to the other zones. However, through offering excellent infrastructure (port, airport, roads) and high quality industrial parks with capable management and support services, it managed to attract leading foreign MNCs in the electronics industry of the ROK. In 1971, these MNCs “imported” only 3 percent of their production components from the ROK, but by 1986, 45 percent of these components were sourced from the ROK. This shows that the zone had achieved its main goal to serve as a catalyst for the production diversification of domestic industry by creating reliable clusters for the high-tech manufacturing sector (Baissac, 2011).

According to the Planning Office of Free Economic Zones at the Ministry of Finance and Economy of Korea, the preferential policies of the ROK SEZs are as described in Table 1.

Countries which are trying to develop SEZs should look at the experience provided by China and the ROK. These insights demonstrate some useful ideas and tactics that could be learnt and replicated by developing countries, such as Mongolia, which is struggling to start SEZs. However, replicating them without considering the substantial differences between countries could lead to failure once again. Thus, adaption of these approaches to the local situation should be the most important aspect of the development of successful SEZs. Next we will have a quick look into the mistakes and difficulties related to SEZ development.

**Table 1: Preferential Policies of the Republic of Korea SEZs**

Sector	Benefits
Tax Breaks	<ul style="list-style-type: none"> <li>• Corporate tax exemptions for the first 3 years and a 50 percent reduction for the following 2 years (for investments of more than US\$50 million, a 100 percent exemption for the first 7 years and a 50 percent reduction the following 3 years);</li> <li>• A flat 17 percent income tax for foreign CEOs and executives at foreign companies;</li> <li>• Capital goods import tariff exemption for 3 years;</li> <li>• Acquisition, registration, property, and aggregate land tax exemptions for the first 3 years and a 50 percent reduction for the following 2 years</li> </ul>
Financial Support	<ul style="list-style-type: none"> <li>• Companies that locate in FEZs will either be exempt from or subject to reduced land fees;</li> <li>• Financial assistance for the construction of facilities, such as hospitals and schools, to make life more convenient for the foreigners</li> </ul>
Deregulation	<ul style="list-style-type: none"> <li>• Minimal land-use regulations governing factory construction and enlargement (currently applicable to the Seoul metropolitan area);</li> <li>• Lift restrictions on businesses reserved for small and medium enterprises (SMEs);</li> <li>• Direct foreign currency payments for ordinary transactions of less than US\$10,000 are allowed</li> </ul>
Employment and Labor Management	<ul style="list-style-type: none"> <li>• Unpaid weekly holidays are allowed (currently paid);</li> <li>• Exemption from obligatory employment of veterans, the disabled, and the elderly</li> </ul>

Educational Improvements	<ul style="list-style-type: none"> <li>• Schools can be established by foreign investors;</li> <li>• Domestic residents can attend foreign schools</li> </ul>
Foreign Hospitals and Pharmacies	<ul style="list-style-type: none"> <li>• Foreign-financed hospitals and pharmacies for foreigners are allowed</li> </ul>
Foreign Broadcasting	<ul style="list-style-type: none"> <li>• The ratio of cable network foreign broadcasting retransmission channels expanded from the current 10 to 20 percent</li> </ul>
Administrative Support	<ul style="list-style-type: none"> <li>• English is allowed for processing of public documents;</li> <li>• Foreign Investment Ombudsman's office will be established</li> </ul>

Source: "Free Trade Zone and Port Hinterland Development", UNESCAP and the Korea Maritime Institute, 2005.

### 3. What Did They Do Wrong?

Despite their relatively successful run, Chinese SEZs had their own difficulties and negative aspects. We can divide them into four main categories based on the experience from Shenzhen SEZ.

I. ***Negative impact on economic indicators.*** Based on some economic indicators some argued that in the early stages of their development SEZs had been used as bridge for durable goods to enter the local market and threatening domestic industry and decreasing foreign exchange, and caused an increase in inflation (Reardon, 1996). Consequently, the government banned imports of 17 durable goods to the SEZs and there were some demands to close the SEZs.

II. ***Investment disparity.*** At the end of 1981, 91 percent of total foreign investment originated in Hong Kong, indicating a huge disparity in investment source. By 1995, 96 percent of Shenzhen's textile industry and 95 percent of its garments industry were owned by Hong Kong investors (Lau, 2001). This was caused partly by the lack of detailed regulations concerning wages, employment and hiring/firing policy. Foreign companies were reluctant to open a business in the zones because they weren't familiar with the Chinese business culture and stated that there was too much red tape. In contrast, companies from Hong Kong were more active in starting business thanks to their cultural similarities and knowledge about how businesses work in China. Similarly, the majority of the Hong Kong investments (71%) were concentrated in the real estate sector alone, due to the excessively high price of land in Hong Kong, which was causing migration to Shenzhen SEZ (China Insights, 2014). As a result, foreign companies started withdrawing their investments and closed their branches in China. The government quickly responded and approved five new regulations to reduce the red tape, especially in entry and exit procedures and wage requirements.

III. ***Speculation and loss of land.*** With the purpose of developing new zones the government started the requisition of rural lands from farmers at very low compensation rates. Between 1992 and 1993, the government granted the rights to 127,000 hectares of land to real estate developers, but only 46.5% of it was actually developed into economic zones (Huang and Yang, 1996). This caused the so-called phenomenon of "zone fever". Even the central government itself promoted this trend by creating 54 new technological zones in 2006. Meanwhile, local governments and municipalities made it worse by declaring their

own special zones, promising incentives and land to real estate developers. Subsequently, this trend quickly grew to its limit and in the 1990s it was impossible to estimate the actual number of special zones. According to a 1993 estimate there were 6,000 to 8,700 zones. In 1994, the government cancelled over 1,000 zones which were established outside of the national and provincial regulations. The negative effects of “zone fever” on the country’s arable land was huge. Between 1986 and 1995, approximately five million hectares of arable land were transferred to infrastructure and real estate development (Cartier, 2001). This trend also continued within the zones as well. In 1986, the government restricted permission to build hotels, restaurants and commercial buildings as they were negatively affecting export output. Hainan SEZ was a clear example. It had the biggest bubble in real estate markets at that time, having almost empty office buildings, hotels and villas. According to Cartier (2001), the concept of SEZs was developed without any causal analyses on arable land and the natural resource base.

IV. **Labor dispute.** Another big problem for Shenzhen SEZ is labor abuse within the zone. 7 million of the total 12 million workers in the zone are contract (migrant) workers who don’t have any legal or social protection. This situation leads to three main violations of labor standards: 1) the use of child laborers; 2) poor living conditions; and 3) excessive compulsory overtime work (Sklaier, 2001). By 2003, half of the firms in Shenzhen owed wage arrears to their workers (ICFTU, 2003). In addition one-third of the workers received less than the minimum wage. Although the minimum wage in Shenzhen increased to RMB 1,500 (US\$240) in 2012, it is still lower than the global market rate and enables China to protect its comparative advantage in labor costs. Unsurprisingly, most workers in the zone are very poor migrant women from rural areas. They don’t complain and send their money home. Occupational health and safety requirements are not up to standard, as illustrated by factory fires, explosions, lost limbs and even suicides by workers (Chan, 2009). The crime rate is also high in the zones. For example, the current Shenzhen crime rate is nine times higher than in Shanghai and it is well-known for human trafficking and the sex trade within China (Goswami, 1997). The simplified customs controls also made it possible to smuggle large amounts of goods through the zones. Two of the original zones, Shantou and Xiamen, were accused of massive tax and smuggling fraud in 2000 and 1999 respectively (Business China, 2006).

Some Chinese academics and leaders have been criticizing the SEZ concepts due to their dark side, which is rarely acknowledged as the dazzle of FDI and the technological miracle blind public awareness. As predicted by Li Peng in 1996, it is becoming more and more realistic that investors will no longer be able to enjoy duty free imports and the low tax rates in the zones. To demonstrate this, we can look at the Shanghai Pilot Free Trade Zone which is experimenting with drastically changed policies (e.g. no fiscal incentives and tax preferences) toward the SEZ development.

#### 4. What Are the Future Trends for SEZs?

Low labor costs, economies of scale, preferential access to markets, duty-free inputs, quality infrastructure and generous fiscal incentives have been crucial elements in attracting

foreign direct investment. However, this era is coming to an end for several reasons. After the 2008–2009 global financial crisis, the United States and European economies ceased to be a global engine of demand and this led the leading companies in global production networks to increasingly consolidate their supply chains both in terms of supply and production locations (Farole and Akinci, 2011).

Furthermore, the expiration of the Multi-Fiber Agreement (MFA) in 2004 almost wiped out the textile and apparel manufacturing SEZs in Latin America, Africa and Eastern Europe in favor of low cost Asian producers. Thus, the countries who haven't established SEZs, yet need to offer something more valuable, are advantageous to the MNCs. The traditional assembly activities of the global production network are no longer attractive to investors unless the country has a huge cost advantage, like Bangladesh and Vietnam, or a big market, like China.

According to Farole (2011), there is a shift away from the traditional EPZ model towards the SEZ model. The main point has been the forward and backward links between the zones and local economies, and a shift away from fiscal incentives to value added services and the presence of an attractive investment environment in the zone. These new concepts of SEZs favor multiuse developments, including industrial, commercial, residential, and even tourism activities. Additionally, there are other SEZs specializing in high-end services, such as information and communication technology (ICT) and biotechnology. Privately owned (in some cases privately operated) SEZs are growing in number (FIAS, 2008).

China has been very active in promoting SEZs in six African countries. They are trying to leverage their own proven model to create successful zones. However, due to major differences between Chinese and African SEZ development bodies (Chinese SEZs are led by provincial or local governments, whereas African ones are being led by private developers) there have been some troubling signs of difficulties.

First, a clear distinction between political support and political objectives is needed in the zone projects. Without any commercial base, which is the source of sustainable competitive advantage, these zones cannot be effective relying only on fiscal incentives. Second, the success of the zones should have a strong connection to the competitiveness of the national economy and national investment environment. However, most projects in Africa are operating in weak local and national value chains that lack access to global markets and have poor infrastructure. Third, there is *de jure* and *de facto* implementation. The lack of a clear and transparent legal and regulatory framework and an authority with the capacity to enforce it has led to disputes and delays in several of the projects (Brautigam and Tang, 2011).

According to Naoko Koyama, expansion of regional trade agreements is creating opportunities and threats at the same time. Even though multilateral trade efforts failed, bilateral and regional trade agreements have been growing rapidly in recent years. Usually selling to the domestic market is prohibited in most SEZs. If a sudden regional agreement erases barriers between the domestic and foreign markets, SEZ policy will have to adapt to the new circumstances in terms of the rules of origin, treatment of exports and fiscal incentives.

On the other hand, such regional agreements are also creating opportunities for smaller countries, giving them access to bigger markets (it is a common finding in SEZ studies that market access is often the number one investment location determinant). Hence, having regional agreements can lead to increased investment opportunities that can improve the competitiveness of an SEZ.

## 5. Where Did Mongolia Get Stuck?

The successful development of SEZs is often seen as the main economic driving force for Mongolia's heavily mining-based economy. Thus, the industrial policy section of the "Action Plan of the Government of Mongolia for 2012–2016" includes several SEZ-related objectives, such as completing the infrastructure of Zamyn Uud FEZ as well as of Altanbulag and Tsagaannuur FTZs by the end of 2015.

In 1995, the Mongolian parliament passed the first legal act for establishing SEZs entitled "Concepts for Establishment of Free Economic Zones". Then, in 2002 "The Law of Free Trade Zones" was passed and initiated the first provisions for the establishment of FTZs. Additionally, laws on the legal status of several FTZs were passed by parliament in 2003 and 2004.

Mongolia is embracing a free trade regime and has opened its markets to foreign investment. Thus, in order to improve export capacity, increase foreign investment flows, and acquire the latest technology, the government decided to establish three FTZs in different areas of Mongolia. Zamyn Uud FEZ is located at the biggest trade port between Mongolia and China. Altanbulag FTZ, on the other hand, is located on the northern border of Mongolia, which is the main port for entering Russia. Tsagaannuur is located at the crossroads of four countries (China, Kazakhstan, Mongolia, and Russia). Their main characteristics are provided in Table 2.

There are several expected benefits from SEZs, including:

- Positive impact on export growth, composition, and the import-substitution sectors: Mongolia's main export products are all mining-related products (89.2% of the total in 2012) and almost all consumer products (close to 90% of the total in 2013) are imported;
- Improvement of the manufacturing sector: The GDP share of this sector was only 8% in 2012. It is anticipated that the most important benefit will be an increase in manufacturing through foreign and domestic investment, especially in the case of Zamyn Uud FEZ;
- Development opportunities for regional and rural areas: Employment, local businesses, and thus the national economy, are expected to greatly benefit from successful SEZ creation;
- High technology, management skills, and know-how are the most sought-after benefits from SEZs.

In 2004, USAID conducted an "Assessment of Mongolia's Free Trade Zone Program and Site Evaluation" for Zamyn Uud FEZ. In the report, two major recommendations were emphasized in order to make the FEZ program successful and competitive, and to align it with international standards. First, it noted that the government had not conducted an economic cost-benefit analysis for the establishment of the FEZ. Second, no full commercial feasibility study for the FEZ had been conducted, including market assessment, market planning, infrastructure requirements, implementation planning, as well as business and financial modelling.

**Table 2: Main Characteristics of Mongolia's SEZs**

Zone	Type of Zone	Location	Objectives	Targeted Sectors
Altanbulag	FTZ (Trade Facilitation & Logistics)	<ul style="list-style-type: none"> <li>• Mongolia–Russia border</li> <li>• 25 km from Sukhbaatar City</li> <li>• 335 km from Ulaanbaatar</li> </ul>	<ul style="list-style-type: none"> <li>• Important transport corridor connecting China, Mongolia and Russia</li> <li>• Free access to third country markets</li> <li>• Developing into a major trade, industry, commerce, and service center in northern Mongolia</li> </ul>	<ul style="list-style-type: none"> <li>• International trade between Russia, China, and Mongolia</li> <li>• Becoming a link between Asia and Europe</li> <li>• Hotels, resorts, and auto service centers</li> <li>• Promotion of rent free spaces for businesses that operate in the auto parts or construction material sectors</li> </ul>
Zamyn Uud	Free Economic Zone (Trade Facilitation & Logistics)	<ul style="list-style-type: none"> <li>• Mongolia–China border</li> <li>• South of Zamyn-Uud City</li> </ul>	<ul style="list-style-type: none"> <li>• Creation of a major commercial, industrial and tourism center</li> <li>• Increase of economic welfare, jobs and business opportunities for residents of Dornogovi and Omnogovi aimags</li> <li>• Benefiting from the transport corridor linking Russia and China</li> </ul>	<ul style="list-style-type: none"> <li>• Foreign trade, manufacturing, tourism, resorts, casinos, and warehousing</li> </ul>
Tsagaannuur	FTZ (Trade Facilitation & Logistics)	<ul style="list-style-type: none"> <li>• 68 km away from the aimag center Bayan-Olgii</li> <li>• About 1,720 km away from Ulaanbaatar</li> </ul>	<ul style="list-style-type: none"> <li>• Accelerate development of western Mongolia through foreign and local investments</li> <li>• Create more jobs and business opportunities for local residents</li> </ul>	<ul style="list-style-type: none"> <li>• International trade between China, Kazakhstan, Mongolia and Russia</li> <li>• Heavy and light industries, hotels, resorts, service industries</li> </ul>

Altanbulag, which opened in June 2014, is the more complete zone in terms of infrastructure. Unlike Zamyn Uud, proper feasibility studies were conducted and a detailed master plan was finalized. Also, costs for infrastructure construction were fully funded by the government (however, in 2013 its budget was cut). According to the governor of Altanbulag Soum, Altanbulag FTZ has already started providing benefits to the local economy. As dams, sewers, roads, and lighting were constructed, and 120–250 new jobs were created, the market for local herders, farmers, and small shops is growing. However, since all the projects are dependent on government-sponsored tenders and bids, planned actions, and construction works, the future development of the zone is lagging.

According to the above mentioned USAID report, we are expecting the following possible outcomes from successfully established SEZs: projected tax revenues, revenues from granting concessions, licenses, production-sharing agreements, job creation, introduction of new technologies and management know-how, as well as backward and forward linkages with other local firms, eventually leading to the formation of clusters and increased incomes.

However, there are also potential costs, such as loss of tax revenues due to tax breaks, expenditure on infrastructure paid by the government, and negative environmental impacts or other negative externalities.

The main reasons for the under-achievement of these FTZs are not small in number. Here are some of the much needed improvements to be made in the areas of the legal and administrative aspects of the FTZs:

- Laws on FTZs are not up to standard. They are incomplete and unclear. For example, these laws are not detailed in the level of supplemental services and activities within the zones and this creates uncertainty in how to establish living standards and working environments for the workers inside the FTZ;
- Inconsistency of the Mongolian governmental policy toward developing FTZs in the long term. After every election, sudden changes of the whole FTZ master plan and an unrecognizable new vision for the FTZs are not a surprise. For example, Altanbulag FTZ has been “officially” opened four times so far and this count may rise further.
- Inability to run FTZs effectively from administrative offices. Even though the administrative offices have a large budget and enough staff, they are mostly outsourced to organize the main activities and events which are vital for developing FTZs successfully.
- Some of the feasibility studies and detailed master plans for the FTZs are not thorough. They lack reliable research and sophisticated insight.
- Funds for infrastructure development of FTZs are scarce. Unreliable government policy, restrictions on FDI and a poor economic situation are making it more difficult to be able to attract investment from abroad.

## 6. Conclusion

Special economic zones have been one of the most effective catalysts for economic development. However, around the world there are not many countries which have enjoyed success with SEZs. China is one of them. Through flexible policy, autonomous municipalities, timely reform, effective government, a significant flow of FDI, public–private partnerships, innovation adaptation, clear goals and local competition, Chinese SEZs, especially Shenzhen SEZ, have fulfilled the goals by serving as catalysts for economic transformation. However, the zones in China didn’t have an easy path in reaching this level. There was the initial negative impact on the economy, a huge disparity in investment diversity, speculation for land, and labor abuse in the zones.

Attracting investment to SEZs has become more and more difficult as the traditional EPZ model is no longer effective for many MNCs. Investors are looking for more than mere assembly activities and newly defined SEZs are offering multiuse developments including industrial, commercial, residential, and even tourism activities (and there are other SEZs specialized in high-end services, such as information and communication technology (ICT) and biotechnology). One interesting trend is the growth of privately owned and operated SEZs.

In the case of Mongolia, it has three SEZs on paper, one of them has recently opened and the others are still in the construction stage. The laws are not complete. SEZs are doing a poor job. Thus, it is necessary to work out further arrangements, such as:

- Developing SEZs based on mining industries using M&A, joint ventures, or licensing.

Mongolia's competitive advantage is in the mining sector. Therefore, we need to exploit that within SEZ development;

- To look into the possibility of joint SEZs with China or other countries. In the east, there could be collaboration with Erlian (Erenhot) on the border with China. In the west, Mongolia could cooperate with Khorgas in Kazakhstan;
- During his visit, Chinese president Xi Jinping agreed to establish joint SEZs between China and Mongolia. He approved that Mongolia would get favorable conditions regarding transportation costs and routes through Chinese territory. It will make a huge difference for trade and manufacturing in the SEZs of Mongolia;
- Building of meat processing and other food facilities in Altanbulag FTZ should be based on the demand estimates for Siberia and the Urals of Russia, as a quota on food products from Mongolia is imposed in these areas;
- Need of a “one at a time approach” to all these separate "industrial parks", "logistics centers", "cluster cities", and so forth. There is a wise Mongolian saying that if you chase two rabbits at one time then you will be left empty-handed.

\* Senior Lecturer, Department of Commerce, Business School, National University of Mongolia

## References

- ADB, *Development of Regional Cooperation Programs for Mongolia and the People's Republic of China*, 2009
- Baissac, Claude, “Brief History of SEZs and Overview of Policy Debates”, *Special Economic Zones in Africa*, February 2011, pp. 23–60
- CAREC, *Country Progress Report on the Implementation Action Plan for the Transport and Trade Facilitation Strategy*, 2009
- Committee for Development, *Opportunity for Free Trade Agreements with Major Trading Partners*, research project, 2012
- Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, “Regional Economic Cooperation and Integration in Asia”, *Special Economic Zones in a Regional and Global Context: Economic Significance and Impact*, 2014
- Farole, Thomas, and Gokhan Akinci, *Special Economic Zones: Progress, Emerging Challenges, and Future Directions*, The International Bank for Reconstruction and Development/The World Bank, 2011
- FIAS, *Special Economic Zones: Performance, lessons learned, and implications for zone development*, The World Bank Group, 2008
- Gopalakrishnan, Shankar, Negative Aspects of Special Economic Zones in China, *Economic & Political Weekly*, Vol. 42, Issue No. 17, 28 April 2007
- Knöth, Claus, *Special Economic Zones and Economic Transformation: The Case of the People's Republic of China*, University of Konstanz, 2000
- Master Plan for Altanbulag FTZ
- Master Plan for Zamyn Uud FEZ

Ministry of Economic Development, *Developing Mining-based Infrastructure*, research project, 2013

NSO, *National Statistical Bulletin 2013*

Wang, Jin, *The Economic Impact of Special Economic Zones: Evidence from Chinese Municipalities*, job market paper, November 2009 version

Wang, Mark Yaolin, and Meng Xiaochen, *Building Nests to Attract Birds: China's hi-tech zones and their impacts on transition from low-skill to high-value added process*, 15th Annual Conference of the Association for Chinese Economics Studies Australia, 2003

Zeng, Douglas Zhihua, *How Do Special Economic Zones and Industrial Clusters Drive China's Rapid Development?*, The World Bank, March 2011

UNESCAP and the Korea Maritime Institute, *Free Trade Zone and Port Hinterland Development*, 2005

USAID, *Assessment of Mongolia's Free Trade Zone Program and Site Evaluation*, 2004