UDC 33.02:330.3 *DOI 10.36074/tmafmseoid.ed-1.15*

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IMPORTANCE OF A FREE ZONES FOR PUBLIC FINANCES

ABSTRACT:

The article is devoted to the problem of replenishing the public funds of a state from free economic zones. Positive aspects of these activities are researched: GDP growth dynamics, improvement of socio-economic indicators, setting up of the revenue part of public funds, etc. Attention is paid to both the successful and unsuccessful attempts of creating of the free economic zones. The review has been made of scientific and practical research on the activities of free zones, which were mainly focused on the private-legal aspects, including investment attractiveness, legal status of the subjects of activity of such zones, types of economic activity, etc. Additionally, the focus was made on the positive aspects of the functioning of the zones, however, there are cases of negative activities and this requires further research. In this article the author is analyzing the public-legal relations regarding the creation and functioning of free trade zones. In particular, the research is made regarding the mechanisms of filling up public funds from economically unattractive territories by setting up the sub-local tax jurisdictions with a special tax regime. Also, unsuccessful attempts to create the free trade zones have been analyzed.

INTRODUCTION.

It is quite clear that different parts of any state are developing based on objective factors like natural and human resources, climate, etc. Public funds will not be filled up from areas without sources of replenishment. In this case, a state will lose nothing if it excludes these territories from paying certain taxes or reduces the respective tax rates. In legislation such territories are called free trade zones (FTZ) or special economic zones. The mechanism to stimulate economic activity and replenish public funds became widespread in the mid-twentieth century and it is still relevant today, because it combines public and private interests.

Free trade zones are created within jurisdictions to promote trade, support new business formation, and encourage foreign direct investment. They provide a preferential environment for production of goods and providing of services primarily for export, whereby a minimum level of regulation is imposed on those companies which operate within such zones. Additional benefits include exemptions from duty and taxes, simplified administrative procedures and duty-free imports of raw materials, machinery, parts and equipment [1]. There are

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as many names for these specially designated trade-promotion areas as there are countries that trade internationally. Apart from the free trade zone designation, some the other common terms for these areas include special economic zones, foreign trade zones, and export processing zones. The International Convention on the Simplification and Harmonization of Customs Procedures (Revised Kyoto Convention) uses the term “free zones” which the revised convention describes as “a part of the territory of a Contracting Party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs territory” [2].

The state territorial jurisdiction involves the sphere of its influence, both at the national and local levels. Local tax jurisdiction, in turn, allows for the possibility of creating sub-local tax jurisdictions with special tax regimes. Since a major objective of creating free zones is to increase export, most free zones around the world are ring-fenced enclaves exempt from national import and export duties or they formally operate outside the customs area of their host country. Governments often add other benefits to the package such as tax, regulatory, administrative and financial incentives [3]. These special tax jurisdictions are a driving force for the development of the territories where they are located as they are an attractive area for foreign direct investments. Free trade zones are the type of incentive, because a state creates the most favorable conditions for the subjects of these zones to obtain a positive financial result. The incentives were used to fundamentally new, high-tech industries or where significant investments are required, such as genetic engineering, neural networks, microelectronics, robotics, aerospace. It should be emphasized separately that by creating favorable conditions for economic activity in unattractive territories, a state and territorial communities ensure the satisfaction of public interest by creating new jobs, increasing population income, improving economic and social infrastructure, creating entities for related services, directly or indirectly related to the activities of the free trade zones, etc.

FREE ZONES: POSITIVE PRACTICE.

The experience of functioning of free trade zones demonstrates a positive effect to GDP growth and its further distribution to public funds. Worldwide statistic is available in public sources [4], so it makes sense to say only that the free trade zones can be safely called the engines of the world economy. For example, there are some successful examples of the free trade zones.

The Shenzhen Special Economic Zone (SEZ) was founded in 1980 as the first in China. It is nearly 2 000 square kilometers, has over 12 million inhabitants. The SEZ has significantly contributed to the transformation of Shenzhen from a fishing village to a major industrial and financial center which has benefited tremendously from the liberal economic policies granted to the SEZ. As the first Chinese SEZ, Shenzhen has served as a pilot for market-oriented reforms. Shenzhen enjoys the most liberal economic policies in China both in terms of FDI and international trade engagement. Examples of the pilot reforms include differential corporate tax rates for foreign and domestic firms. Migrants from across China account for 83% of the population of Shenzhen and less than 6% are over the age of 60. This combination has led to an innovative economic environment. Shenzhen has also built its success on the availability of capital. In 2005, the third of the venture capital firms of the whole country were in Shenzhen. Foreign direct investment has played a major role in the development of Shenzhen. Within Shenzhen there are 15 free trade zones, 17 export processing zones, 5 economic and technological developments zones, 53 high technology developments zones and 15 border economic cooperative areas [1]. SEZ receive special tax benefits and preferential treatment for foreign investment. Shenzhen grew exponentially and its GDP per capital grew 24,569% from 1978 to 2014. Shenzhen's GDP surpassed U.S. $338 billion in 2017 because of its successful tech sector [5].

The Tangier Free Zone - located on the African side of the straits of Gibraltar, just 14 km from Europe, the Moroccan port of Tangier. The zone reflects the emerging trend of moving away from classical export-processing zone development towards zones with a multisectoral development approach. It was inaugurated in 1999 and became operational in 2000. Located inland near the airport, it covers some 345 hectares and includes some 400 companies. In the 10 years since its inception the industrial users of the free zone have invested some €7 billion [6] in their facilities. Some 60,000 jobs have been created; these workers have added significantly to Morocco's exports. In 2008, the free zone accounted for a tenth of Morocco's industrial exports, totaling €1.2 billion [3]. Attractive tax benefits of the zone: exemption from registration and stamp duties for the constitution or increase of capital and the acquisition of land; patent tax exemption for 15 years; exemption from business tax for 15 years; exemption from corporate income tax for 5 years and reduction of the rate to 8.75% for the next 20 years; exemption from tax on equity products, shares and similar income for non-residents; exemption from VAT on goods from abroad or the subject territory. The zone has a special customs regime in the form of exemption from import duties, taxes and import surcharges, tax on consumption. Also, the Kingdom of Morocco, may grant financial assistance for the acquisition of land and/or the construction of production units for certain sectors of activity. This subsidy can reach 100% of the price of the land. The release of this aid is conducted within a period not exceeding 60 days after submission of supporting documents [6].

Mariel Special Development Zone is the first of its type in Cuba and enjoys a privileged geographic location, in the center of the Caribbean Sea, at the crossroads of the main maritime commercial traffic routes in the Western Hemisphere [7]. Cuba's government has approved 27 enterprise plans, including leveling and fencing in a 25-acre plot of land for the development of the BrasCuba factory. Cuba's government hopes the zone will eventually attract $2.5 billion in annual foreign investment, though that is a long-term ambition. Six Spanish companies have received approvals to operate in the zone, whereas zero US companies have received approvals. An estimated 7,000 workers already work in the zone [4].

FREE ZONES: UNSUCCESSFUL PRACTICE.

However, world experience contains examples of unsuccessful attempts to implement such incentives. The Concept of creating a free economic zone in Ukraine, approved in 1994, allowed various economic activities with incentives applied. Among the promising directions were: banking and insurance zones - zones in which a particularly favorable regime for conducting banking and insurance operations in foreign currency; touristic and recreation zones - created with the purpose of intensification of entrepreneurial activity (including with the attraction of foreign investors) in the sphere of recreational and tourist business; scientific and technical zones - a special legal regime which focused on the development of scientific and industrial potential, the achievement of a new quality of the economy through the stimulation of fundamental and applied research, with the further introduction of the results of scientific development into production.

The directions of economic activity provided by the Concept were not accidental. Considering the lack of private capital and a modern electronic transfer system, there was a need to build a strong banking system. The insurance market was absent at all. In turn, the tourist and recreational sector of the economy was based on the needs of domestic tourists, as there were no foreigners. Therefore, investing in the building of new resort areas would have had a significant impact on local public finances. Regarding investment activity in the scientific and technical field, a significant amount of higher education institutions, laboratories, design offices and skilled labor resources, implied the rapid development of new technologies. This industry needed only financing for a project and a modern logistical base. All of this would have been realized in the first stage (1994-2000).

Unfortunately, none of the promised has been done in the 90s and still is not implemented today. The state's economy did not receive funds from the private sector, which in turn were not distributed in public funds. Another problem is the waste of time, as it is currently not economically and legally possible to create an offshore area in Europe.

Considering the rapid development of the digital economy, which began in the twenty-first century, the legal regulation of the twentieth century no longer meet the new requirements. In addition to the aforementioned failures of the free economic zones' activity on the territory of Ukraine, the problem was also that the beneficiaries of the subjects of economic activity in such zones were residents of Ukraine who carried out their activities for the purpose of tax evasion or tax reduction. Foreign direct investment came in lesser amounts. The activities of the subjects of the zones, at the legislative level, were aimed not to achieve a positive socio-economic effect, but to reduce the tax burden. Given the lack of satisfaction of public interest, as of 2005, the preferential tax conditions in these territories were discontinued and their investment attractiveness disappeared. In the case of Ukraine, the termination of the fee economic zones operation was a fundamental mistake not because of the decrease in public funds, but because the state had breached its commitments to guarantee the activities of the subjects of the zones. Due to this, the state suffered a damage to its public image.

Despite the tax reform, the tax legal regime in the free zones territories remained unchanged - the free economic zones existed without any tax preferences. Nine years later, in 2014, in order to regulate social economic relations, resulting from the temporary occupied territory of Ukraine, the Parliament of Ukraine, contrary to the provisions of the Constitution of Ukraine and national tax legislation, adopted a law on the creation of a free economic zone in the temporarily occupied Crimea. This legal act for ten years established the peculiarities of the legal status of the Free Economic Zone "Crimea" within the two administrative-territorial units of Ukraine: the Autonomous Republic of Crimea and the City of Sevastopol [8].

In order to properly understand the issues of legal regulation of financial relations in the Autonomous Republic of Crimea and the City of Sevastopol, it is advisable to start with an analysis of the legal status of these territories. The legal status of the Autonomous Republic of Crimea is determined by the Constitution of Ukraine [9], the Law of Ukraine "On the Autonomous Republic of Crimea" [10] and the Constitution of the Autonomous Republic of Crimea, approved by the law of Ukraine. At the legislative level, the special legal status of the City of Sevastopol is defined in the Constitution of Ukraine, however there is no separate law. Analyzing the legal norms, one can see that the Autonomous Republic of Crimea is an integral part of Ukraine and within the powers, defined by the Constitution and laws of Ukraine, its authorities solve issues related to their responsibility, in particular, to determine the structure and directions of economic development, directions and priorities of investment activity, granting of benefits to investors, including foreign ones, solving of other questions of investment activity; creation and maintenance of free trade zones. The financial autonomy of the Crimea is guaranteed by the laws of Ukraine regarding the revenue part of the budget on a basis of national taxes and fees that are fully attributed to the budget of the Republic of Crimea. Consequently, the public authorities of the Republic have been empowered to regulate financial and economic relations independently within the limits of their competence and jurisdiction.

At the same time, the Parliament of Ukraine, without changing the current legislation on the legal status of the Autonomous Republic of Crimea, adopted a law, which created a free trade zone on the whole territory of the Republic. The decision is debatable, not only from a legal standpoint, but also from an economic point of view - this territory is temporarily occupied, for which the world community has imposed a sanction regime, accordingly, there are no state guarantees, real preferences and investment attractiveness. It is quite ironic to mention the preamble to the Concept of creation of free economic zones in Ukraine, according to which free trade zones were defined as one of the instruments to open the economy of Ukraine to the outside world and stimulate the international economic cooperation on the basis of attracting foreign investments.

Remembering the legal regulation, it is appropriate to note that the tax legislation of Ukraine provides for the possibility of granting tax preferences to economic entities in cases and in the manner determined solely by the Tax Code of Ukraine by establishing a special tax regime, which may provide for a special procedure for determining the elements of tax and levy exemption from payment of individual taxes and fees. If a free trade zone created, Section XIV "Special Tax Regimes" of the Tax Code of Ukraine must be supplemented by an appropriate subdivision to determine the tax preferences for the economic entities of that zone. However, the FEZ "Crimea" created tax preferences for all individuals and legal entities not by amending the rules of the Tax Code of Ukraine, but by enshrining in the law, which is not part of the tax legislation of Ukraine the norm according to which in the territory of the FEZ "Crimea" absolutely all national taxes and fees are covered. It is obvious that the legal regulation of the free trade zone in the temporarily occupied territories is inappropriate.

As of 2019, a list of free trade zones on the territory of Ukraine is available on the website of the Ministry of Economic Development, Trade and Agriculture of Ukraine: "Azov", "Donetsk", "Zacarpathia", "Interport Kovel", "Kurortopolis Truskavets", "Mykolaiv", "Porto-Franco", "Port Crimea", "Reni", "Slavutich", "Yavoriv" [11]. Actually, there is no SEZ "Crimea". Why it is absent - is a rhetorical question, along with three more questions that makes no sense to answer: first, what are the peculiarities of the taxation regime in the above-mentioned territories of the free trade zones; second, what is the investment attractiveness of FEZ "Port Crimea", FEZ "Donetsk", FEZ "Azov"; third - what is the economic feasibility of functioning of FEZ "Port Crimea" and the territory of FEZ "Crimea".

CONCLUSION.

Therefore, summarizing the abovementioned, we can conclude that reducing the tax burden on business entities in certain regions of the state or in certain sectors of the economy by creating free trade zones leads to increased economic activity. As a result, the state receives revenues from centralized public funds not from direct taxes paid by legal entities, the subjects of economic zones, but from indirect taxation included in the price of goods manufactured or services rendered. It is also worth noting that the revival of socio-economic activity in a certain territory will lead to the filling of local budgets, from the payment of income tax.

Decentralizing public funds of territorial communities, the state should use real instruments that can help create a strong regional economy on the territory. One such tool is, of course, the free trade zones. New infrastructure and dynamic development of the territory where the free trade zone is located will promote economic ties with related sectors of the economy, which will positively affect other regions of a state.

Benefits from a free trade zones for a state are both static and dynamic, of which static benefits are intensified in developing economies. Static benefits include foreign exchange earnings; government revenues; foreign direct investment; export growth and its diversification; direct employment and income generation. The second type of benefits, dynamic benefits, are more important in terms of long-term impact of zone development but are generally harder to measure. Dynamic benefits include technology transfer, regional development, indirect employment creation, female employment, skills upgrading [12].

It is worth to pay attention to the expediency of a comprehensive approach to the introduction of such an instrument as free trade zones. Economic analysis of the development indicators of regions and sectors of the economy should be carried out according to different criteria for the expediency of reducing tax pressure.

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