NATIONAL AUDIT OFFICE
OF THE REPUBLIC OF LITHUANIA

PUBLIC AUDIT REPORT

DEVELOPMENT OF FREE ECONOMIC ZONES AND INDUSTRIAL PARKS

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Vilnius

SUMMARY

Audit started 12 October 2011
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Full audit report in Lithuanian is available on the website
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With increasing global competition, every state seeks ways how to attract local and foreign investments aiming at economic growth and higher employment rate. An investment-friendly environment consists of the overall competitiveness of the country and its business environment, high qualification of the labour force which is at the same time inexpensive, attractive tax regime, political stability, and other factors.

As one of the ways of attracting investments, Lithuania has chosen development of industrial areas where an attractive environment for greenfield investments is created by offering infrastructure and certain tax incentives. The industrial areas developed in the country are of two types: free economic zones (FEZ) and industrial parks (IP).

The main objective of the audit was to assess whether the development of the industrial parks and free economic zones has been sufficiently effective. Having analysed problems of the industrial parks, the Ministry of Economy has initiated conversion of five of the eight existing IP to FEZ. During the audit we examined preparation for IP activities and their results, the ongoing conversion of IP to FEZ and the business model of the FEZ which are currently operated in the country.

Having assessed the audit evidence collected, we made the following conclusions and recommendations:

Audit conclusions

1. The first year of the IP operation was not successful because of a failure to attract the planned number of investors. The IP operation did not start properly because of a lack of preparation:

1.1. there is still no legislation in place regulating IP operation and management principles;

1.2. the issue of sub-lease of the state land of these parks has not been settled yet, which prevented selection of a private operator;

1.3. the management of these parks has not been transferred to private operators, municipalities have not established positions responsible for search of IP investors and provision of services thereto, and marketing activities were started too late.

2. To date, only 13 per cent of the area of the operating FEZ and 10 per cent of the area of the industrial parks have been leased to investors. Nevertheless, the industrial areas are further expanded without having assessed their actual demand and the effectiveness of investments.

3. Obligations, distribution of risks and responsibilities between the state and FEZ management companies are planned to be defined more specifically for new free economic zones; however, there are a number of shortcomings in the operation model of the already functioning FEZ which may prevent achievement of their establishment objectives:

3.1. there is no clearly regulated distribution of investment risks, obligations and responsibilities between the state and the FEZ management companies, though the development of the FEZ is mainly funded by the state and their management companies have been granted an exclusive right to lease and manage the area on easy terms providing special favourable economic and legal conditions, which prevents effective development of the FEZ.

3.2. There is a lack of proper supervision of the free economic zones: the FEZ management companies do not provide reports in accordance with the requirements of legislation, the Ministry of Economy, which is the institution responsible for state supervision of the FEZ, has not set any performance effectiveness criteria, it has not been analysing the performance of the FEZ and their impact on the national economy to a sufficient extent and has not been monitoring execution of the obligations of the FEZ management companies.

3.3. Lately, private lots of land owned by natural and legal persons have been included into the area of the free economic zones, although the state does not intend to purchase these lots. However, such model has not been regulated in any legislation.

3.4. The FEZ management companies have leased only part of the state-owned land. The Government has still not approved the boundaries of the entire territory of Klaipėda FEZ and stages of the development of this area, therefore the state land in the FEZ has been managed insufficiently effectively.

3.5. The state land lease tax at a reduced rate of 50 per cent applicable to FEZ management companies in accordance with the legislation is not useful for investors because they are not offered this benefit by the FEZ management companies.

3.6. The state has failed to keep the documents of the international tenders held to select the best business plans and statutes for Kaunas and Klaipėda FEZ and to choose the groups of founders; in the absence of such documentation, the execution of the agreements on the establishment of the FEZ cannot be assessed.

4. Establishment of IP is only one of the measures for creating more favourable conditions for the attraction of investments and not the key factor which encourages investments. Therefore it can happen that their conversion to free economic zones, attracting investments with additional tax incentives only in specific areas, will not produce effective integrated results if no long-term investment attraction strategy is in place.

Proposals

To the Government of the Republic of Lithuania:

1. To approve clear criteria and indicators defining cases when the state will continue investing into the development of the infrastructure of specific FEZ, with a view to ensure sustainable development of FEZ and efficient use of the state funds;
2. To set the boundaries of all FEZ observing the same principle, including infrastructure corridors;
3. To take measures to ensure that FEZ management companies lease the entire area of the zones in accordance with the procedure established by law;
4. To set the boundaries of the entire area of Klaipėda FEZ and its development stages;

5. To assess conformity of the storage of the documents of the international tenders held to select the best business plans and statutes for Kaunas and Klaipėda FEZ and to choose the groups of founders to the legislation, and to address issues of liability in case of document storage violations.

To the Ministry of Economy:

6. To take measures to impose specific obligations on the FEZ management companies related to the FEZ development and performance results, and to provide for liability for failure to meet these obligations;

7. To initiate amendment of legislation or to provide for sharing of the development, maintenance and funding of the infrastructure and liability in the agreements with FEZ management companies;

8. To provide for measures to ensure state supervision of FEZ, their performance analysis and economic impact assessment. Summary results of the performance of the FEZ operating in Lithuania should be made public;

9. To initiate legislative changes and to adopt a procedure for the inclusion of privately-owned land in the FEZ territory and for its use for FEZ operations;

10. To initiate regulation of the operation and management principles of industrial parks.