Assessment of the operation of Free Economic Zones

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No. VRE-4

SUMMARY

The Relevance of the Assessment

Investment is the source of employment, knowledge and competitiveness, and is the key to economic growth, faster development and increased attractiveness of weaker regions. Foreign and domestic direct investment enables people to earn and live better. The aim is therefore to put Lithuania on the map of business investment and strengthen its position in international markets[1].

„*Making every effort to attract investment from global companies to Lithuania*" is one of the key top-level strategic directions of our country's economic transformation.[2]. One of the tools to help the country achieve this goal is free economic zones[3]. The development of existing free economic zones, as well as industrial parks and industrial territories, and the expansion of their boundaries are included in the list of strategically important economic development projects[4], and the programme of the 18th Government approved by the Seimas[5] speaks not only of the need for the development of these zones, but also of the need for the creation of new zones.

Assessment objective and scope

The objective of the assessment is to evaluate whether the government's strategy for free economic zones provides the preconditions for optimal added value from their operation.

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[1] Investicijos | Ekonomikos ir inovacijų ministerija (lrv.lt), referred to on 13/02/2023.

[2] Available at: XI-2015 Dėl Valstybės pažangos strategijos „Lietuvos pažangos strategija „Lietuva 2030" patvirtinimo (lrs.lt), referred to on 22/02/2023.

[3] Available at: 998 Dėl 2021–2030 metų Nacionalinio pažangos plano patvirtinimo (lrs.lt), referred to on 22/02/2023.

[4] In accordance with Annex 2, paragraph 3 of the text part of the general plan of the territory of the Republic of Lithuania, approved by the Government Resolution No. 789 of 29 August 2021, it is planned to extend the boundaries of Kaunas, Klaipėda, Akmenė FEZs.

[5] Resolution No XIV-72 of 11 December 2020.

Key areas for assessment:

- Performance indicators of the free economic zones;
- Investments into the free economic zones;
- operation and supervision of free economic zone management companies.

Audited entity – Ministry of Economy and Innovation.

We interviewed all municipalities and free economic zone management companies during the assessment. We used analyses carried out by the public undertaking Invest Lithuania, monitoring reports on the zones' performance, and contacted members of the Lithuanian Confederation of Industrialists, the Association of Lithuanian Municipalities, and the Association of Lithuanian Free Economic Zones (Annex 2).

The period covered is 2020-2022. To assess changes, we have also used data for 2019.

Main Results of the Assessment

The government's strategy for and regulation of free economic zones does not provide sufficient preconditions for them to deliver optimal added value, as there are no nationally defined expectations for the operation of the zones, their performance indicators are not ambitious, and there is a need to improve cooperation between the zones, state and municipal authorities in order to attract investment. Lack of public land and underdeveloped infrastructure are the main obstacles to the development and expansion of zones.

Performance Indicators of the Free Economic Zones

The strategic planning documents foresee the development of free economic zones and the creation of two new ones, but do not foresee separate measures and investment amounts for the development of the zones' engineering infrastructure, do not set specific targets for the zones' performance, and hence do not identify the added value that the zones' activities are expected to bring at the national level (Section 1.1, p. 11).

The performance indicators for each zone management company are set out in the contracts, but 5 (out of 7) do not include an occupancy rate (%) for the zone area. Other indicators are set in absolute terms (investments - thousands of EUR, jobs - units), for 5, 10 years or for the entire duration of the contract (49 years), and there is no provision for reviewing them, which may make them irrelevant and unambitious due to economic, technological, etc. changes. The indicator for job creation focuses on the number of jobs created rather than the number of people actually employed.

In 2021, 1 000 jobs were created in enterprises in the zones, although the actual change in employment may have been around one third of the jobs created. In 4 (out of 7) of the zones, the investment and job creation rates achieved by the zone management companies were significantly above their target values (by a factor of 1.5 to 72 times) before the end of the intermediate period or below (by 11% to 72%) by the end of the intermediate period. Management companies were not sanctioned for non-achievement of the indicators, even though they were contractually obliged to do so (Section 1.2, page 12).

The law sets targets for the use of regional infrastructure and high-tech development in the zones, the achievement of which is not measured. No performance indicators related to the use of regional infrastructure (seaport, Kaunas airport, railways and motorways) have been set for the Kaunas and Klaipėda zones; no performance indicators related to the development of high-technology or the advancement of science have been set for any of the zone's management companies. According to the data collected by the auditors, 78% (71 out of 91) of the enterprises operating in the territory of the zones in 2023 were not engaged in high-tech activities (Section 1.3, page 15).

Nationally defined performance indicators, consistently reviewed for each zone, including targets for high-tech development and the use of the region's infrastructure, would allow free economic zones to operate with relevant, ambitious targets, and would encourage the attraction of higher-technology enterprises, thus generating optimal added value for the country (Section 1.3, page 15).

Coordination of the Free Economic Zones

The Ministry and the public enterprise "Invest Lithuania" use the data provided by the management companies to coordinate and monitor the activities of the zones, although they have doubts about the reliability of the collected data, do not take any measures to adjust the data, and collect information from other sources. There is no generalised and reliable data on the infrastructure projects developed by the zones (their sources of funding, the objects to be developed) and the planned progress of infrastructure development. The repetitive and inaccurate nature of the primary data provided by the management companies makes it difficult to use it for reliable analysis (Section 2.1, page 18).

The management companies cooperate with municipalities and other state institutions (the Ministry and Invest Lithuania) in addressing issues important to the zones. The quality of cooperation with all of them is assessed as good, but the management companies would benefit from more feedback on the number of times that investors have expressed interest in and considered specific zones (section 2.2, page 19).

Foreign direct investment grew throughout Lithuania in the period 2019-2021, regardless of whether the zone is located in a county or not, e.g. in Telšiai, Alytus, Utena counties. In order to attract investment nationwide, the focus is not only on the development and expansion of zone territories: in 16 out of 22 planned plots or territories, the development of industrial parks and other industrial areas is planned, while in the other 6, the development of zones is planned together with the above mentioned territories. 95% (56 out of 59) of municipalities consider their territories attractive to investors because of the infrastructure they have developed or the assistance they have received in developing it, while 54% (32 out of 59) consider their territories attractive because of the other investment incentives in place. All municipalities across the country are taking measures to attract investments: 56% are actively looking for potential investors, 54% are applying tax incentives, and the majority - 68% - are focusing on the creation and development of district infrastructure. 34% of municipalities associate the greatest benefit to their territory with the establishment of industrial parks, including 3 (out of 7) that already have free economic zones. According to the Confederation of Industrialists, investors are more attracted by a well-developed infrastructure than by the tax incentives that apply only in the zones (Section 2.3, page 22).

The creation of new zones and the development of existing ones are foreseen. In the absence of reliable investment data, it is not possible to compare them, to analyse the progress of infrastructure investment and to make informed decisions on attracting new investment or other decisions related to the development of the zones. Without developing closer cooperation, and without feedback from zone management companies and municipalities on the decisions of potential investors, the opportunity to build investor confidence and to develop available sites in the most targeted way is being missed (Section 2.3, page 22).

Management and Development of the Free Economic Zones

The business plans of the zone management companies were based on the designated areas, but following the implementation of the legislative changes, the total area allocated to zone activities has been reduced by 30% (from 2 008 ha). The shortage of public land resulted in 8.4% (121.2 out of 1 433 ha) of the designated area not being transferred to two zones. According to 2021 data, only 27% (382 out of 1 433 ha) of the 1 433 ha of the designated area of the zone has been subleased to companies, while the remaining 73% does not generate any added value, due to the lack of plots of land available to meet the needs of investors: 29.8% (313 ha) of the remaining unleased area (1,052 ha) consists of undeveloped areas, which will not be available for operation until 3 years from now, while 45.2% (476 ha) of the area is not available for operation at all (servitudes, buffer zones, etc.) (Section 3.1, p. 25).

The development of areas for attracting new investment and expanding existing ones up to 2030 may not be smooth, as 18 of the 22 areas are planned to cover an area of between 10 and 42 hectares, which may be insufficient to meet the demands of large investors; 42% are not familiar with the development plan; 19% consider that the areas foreseen for development are insufficient; the development of existing and identification of new missing territories of Kaunas, Klaipėda, Akmenė zones is foreseen, but due to the shortage of state land, not all of the designated areas have been transferred to these zones. The restoration of the Kaunas zone to 1 054 ha may face the same challenges that have already led to the reduction of the zone's area, i.e. the complex and lengthy takeover of private land for public use and the decision to relinquish the areas of state forest (Section 3.2, p. 27).

Without the transfer of the designated areas by the State and with insufficient infrastructure in the zones, the indicators set for the management companies may not be met and the added value of the zones may be lower. Without sufficient plots of land that are attractive to investors, the zones are also deprived of development opportunities. Inadequate communication of development plans for attracting investment and development planning in areas already facing a shortage of suitable public land may lead to failure of the planned development and may not ensure the country's competitiveness in attracting investment (Section 3.2, page 27).