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OUTSOURCING TO CENTRAL AND EASTERN EUROPE: THE FREE ZONES ROLE

Globalization refers to the progressive and growing amalgamation of national economies of most of the advanced-industrialized countries of the world, and of an increasing number of developing nations, to the degree that we might eventually be witnessing the emergence and shaping of a single enlarging worldwide economy.

This enhanced integration of world economic activity consists of increased cross-national flows of a greater variety of goods and services, more extensive cross-border flows of short-term and long-term capital, and an increasingly dense and complex system of transnational production networks, involving multinational enterprises as well as independent local supplier companies and new permanent settlements in a vast multiple forwarding of outward industrial processes and outsourcing of industrial production segments.

The present stage of *globalization, liberalization* and consequent intense and expanding economic activities has rapidly swollen in recent years, over all the industrially developed world and has recently produced a *shift from low wage labor* to *specialized labor,* by and large towards capital intense processes spread worldwide trough industrial delocalization. The most direct way to understand the outcomes and results over growth and income distribution in developing and middle - income areas, is in terms of the three major noticeable fall-outs:

- *the Country external balance of payments;*

- *flow of inward bound payments* such as wage remittances (an important provider to local incomes in countries with large emigrant populations), interest, and dividends transferred;

- *streams of financial capital,* including FDI and general recurrent portfolio movements.

The main reasons of such developing features may include, first of all, the circumstance that there have been recent continuing overwhelming improvements and innovations in transportation technology, which in turn has reduced the costs of international exchanges of goods, services, capital, and technology itself.

In the first era of globalization, mostly European denominated, and somewhat linked to the gold - standard, the advances in transportation turned around sea transport, and widespread railways deployment, just to be remembered the cutting of the isthmus of the Suez Canal and the deployment of the railroad Vienna-Trieste, the *Transalpina,* which reduced transportation costs for goods possibly by as much as 50% between 1860 and 1913.

It came out that ocean-shipping costs continued to decrease, as well, during the early years after World War II, but then levelled down by the early 1960s. With same effect, recent remarkable progresses in air transport technology have strongly reduced airfreight costs, possibly as much as 80% trough the last fifty years in the twentieth century.

Definitely even more important than cost-cutting, improvements in transportation equipments and hardware, advances in communications and computing·technology, have all created new opportunities in the present age, both for trade development and cross-national financial transactions under strong economic collaboration structures.

Computers have become vastly more powerful and without doubt less expensive throughout the recent computer era which continues to improve rapidly and deeply and might lead to a huge common single language integrated operating system network, restructuring the vast damages and shortcomings caused by the senseless existence and intermingling of more than 60,000 world languages.

Third, firms have learned how to take advantage of the recent advances in transportation, communications, and computing technologies in such a way as to become more active in the world economy, taking advantage of all the arbitrage space in wages, social costs, availability of capital, taxation discrepancies and other relevant available resources and circumstances.

Management in multinational firms has gained control of relevant cheaper telecommunications and entrusted increasingly powerful hardware and software systems and, finally, during the past decade, the internet and intranet relations, to coordinate all the operations of their subsidiaries and their independent suppliers and clients across national borders and more often even across most of the continents.

In an opening social and political enlarging surrounding, the peculiar location of Trieste and Gorizia and the interlinked new harbor system of Monfalcone - Trieste - Koper, within the Friuli - Venezia Giulia Region, on the rise across the Slovenian Border, at the far northern end of the Adriatic sea corridor, are suggesting a closer and enlarging commercial, logistic and financial high profile function within the new setting.

Hosting the BRD representative office, the Secretariat of the 5th European Corridor and lodging the CEI *Central European Initiative* General Secretariat Headquarters, the potential North Adriatic logistic platform seems ready and fully active in promoting economic growth and expanding the economic capacities in Central and Eastern Europe, through supporting the industrial outsourcing processes considering the attractive potentials of local developing industrial districts and Free Zones infrastructures worthy of note the world over.

Such a critical local provider and supportive infrastructure function seems now appropriate in the following improving fields, related to the globalization process, which are rapidly transforming the traditional market notion and awareness and the industrial cycles in a growing borderless world-wide dimension and market surroundings:

- industrial out-task outsourcing procedures (de-industrialization processes flowing from developed countries towards less developed areas levelling off existing divergences),

- *outward industrial processing procedures*, application of *regulation 2913/92* - within the EU Custom Code - and considering the new WTO policies with regard to the rejection of all the tariffs and barriers strongly hampering the economic integration of LDs Countries,

- implementing OECD policies in supporting and promoting FDI in underdeveloped areas, as barrier and remedies to mass immigration and social and political turmoil in a challenging world,

- providing administrative and accountancy support, back office services in the global enterprise networks,

- pioneering financial services, banking and insurance products development,

- holding companies harbouring and providing special lodging facilities,

- setting up of logistic operational *back office* infrastructures and management training activities,

- organizing spot and future commodities trading and delivering facilities, issuance of warrants and related hard copy and electronic documentation, which reflect typical local professional consolidated expertises, connected to the world-wide booming outsourcing ongoing patterns up to the full life-cycle of *design, assembling and delivering* production segments, when outsourcing stages may figure out teaming relationship of enhanced services to the end users, joint marketing and horizontal and vertical industrial integration as now happens in Rumania, recently nicknamed *Little Italy*.

The ongoing recognition of the Professional Activities and Titles and the related European Directive 89/48/CEE - Council of Europe 21st December 1988, within the enlarged EU framework and specifically within the Central European area Countries, allows a set of initiatives in order to strengthen all the possible links allowing the activation of a professional technical hub connecting local data banks and resources, on the ground of a growing synergy and related shared actions.

The basic existence of interlinked Professional entities, and strictly working teams within the CEI Countries, connected through an open data bank collecting taxing rules, legislation, mailing lists of potential available professionals and other similar synergetic resources may induce, in this remarkable moment, effective and valuable consideration through the following expanding actions within the present global administrative deregulation stage within the same area and possibly farther eastward:

- outsourcing human resources, skilled labour training and consequent implementation of industrial production and logistic operations on an enlarged multinational geographical level; (at present more than half of all the Italian shoes and a relevant part of fashion items come from Rumanian, Tunisian and third Country's outsourcing permanent establishments);

- development and promotion of already existing *Free Economic Zones* operating within Central Europe, outside the EU and their exploitation through setting up and addressing of outsourcing industrial processing procedures (the experience is recent since most of the free zones have been established during the '90);

- outsourcing sponsorship by means of a data bank delivering existing European Union programmes, incentives and local funding sources to operators in the financial and joint-ventures projects sectors specially if related to SME;

- promotion of general information about existing taxation facilities and agreements against double taxation with regard to relevant national and international accounting standards, through harbouring back office activities including holding companies management and general accounting and administrative technical assistance;

- endorsement of specific significant legislation providing enterprise and corporations rules and practices regarding foreign direct and indirect investments and activating a possible secondary market of existing operative subsidiaries and branches, to be executed free from local capital gain taxation;

- upholding logistic and transportation infrastructures and services within already existing regional logistic platform facilities and new ones to be established.

Furthermore, *International outsourcing* might be additionally developed notwithstanding its already large volume through many forms of local back-up specific instruments and shelters:

- export enhancing, either directly or by subcontracting of specific functions to foreign enterprises for external performance (the *out-tasking* model), for use in the customer's home country after process;

- partial exportation of a task, such as the accelerated design through full time design operations using cooperating teams in different areas (another *out-tasking* model);

- reliance upon foreign external enterprises to support foreign subsidiaries of U.E. and non U.E. customer (the *foreign local subsidiary or branch* model). This is typically a part of the *global outsourcing* (across territorial boundaries), but could equally be done country-by-country and managed by the headquarters staff, in-house, in the home country or regional *back-office premises* through the North Adriatic Hub.

In order to clarify the local impact of taxation over international activities, carried out and managed through a local inland back office in a Special Zone, it is sufficient to consider that, at present a foreign owned Italian resident holding company is almost exempt from any taxation on all the activities performed in Central Europe (at this moment 1,80% of taxes on foreign income (36% over 5% of income earned), and the related incomes are free from withholding taxation in exiting Italy.

Several global *multilateral outsourcing models* may be properly adopted in managing all the related activities:

- establishment of a jointly owned subsidiary for the provision of shared services through participants to affiliates: the general *shared services* model;

- reliance upon a multinational enterprise to support a multinational customer's operations in multiple countries: the *global multilateral outsourcing* model. This model provides state of affairs involving *private label* services by the outsourcer to set and start up and eventually create foreign business infrastructures. Private label outsourcing is expanding rapidly, particularly with regional telephone call centres for *customer care* and related domicile services;

- coordination centres of multiple foreign operations within Central and East Europe with broad-band support in telecommunications, data processing, financing and back office accounting services, call centres, internet circuits and general after sale activities;

- establishment of a secondary market for counter trade activities trough transferable credit trading activities (back to back and multiple transferable instruments).

From the outward processing procedures, a technological fall-out is expected on most of the hosting Countries, as long as a spill-over is unavoidable, with regard to the transfer of know-how and expertise, in most cases workers are trained in principal Countries and full equipment is delivered from same locations with adequate instructors and skilled technicians.

Such a model has been the viable engine for most of the recent Far East and South American Countries development and may be easily duplicated in Central and Eastern Europe. The problem lies with the availability of enough information and useful connections with mature requiring industrial Countries and some specific *outsourcing exchange facility,* in order to offset demand and offer of specific *over all activities* and processes and production units available on one single trading platform.

Table 1: Inflow of foreign direct investments into CEE countries 1989-1998 mil. USD

	Austria	Germany	Czech Republic	Hungary	Poland	Slovakia	Total CEE
1989	587	7 152	n.a.	187	11	10	208
1990	653	2 532	n.a.	311	89	24	424
1991	360	4 108	n.a.	1 462	291	82	1 835
1992	1 442	2 642	983	1 479	678	100	3 240
1993	1 129	1 946	654	2 350	1 715	199	4 918
1994	2 117	1 936	878	1 144	1 875	270	4 167
1995	1 901	11 986	1 118	2 819	3 659	236	7 831
1996	4 485	8 429	1 435	2 274	4 498	351	8 558
1997	2 624	11 663	1 286	2 167	4 908	174	8 535
1998	6 034	20 145	2 737	2 037	5 761	562	11 098
1999	2 979	52 230	5 091	1 650	5 589	354	12 684
89-99	24 311	122 769	14 182	17 880	29 074	2 382	63 498
Per cap.	3 001	1 477	1 377	1 779	751	437	

Source: IMF Statistics, EBRD

Table 2

FDI stock, USD million, end of year

	1990	1993	1994	1995	1996	1997	1998	1999	2000	2001
Albania	.	73	131	201	291	336	384	425	568	890
Bosnia and Herzegovina	.			.	.	.	100	190	340	470
Bulgaria	4	141	247	337	446	951	1488	2257	3309	3897
Croatia	.	129	238	369	874	1425	2428	4075	5292	6783
Macedonia	.	.	19	28	40	56	173	285	381	824
Moldova	.	14	29	93	117	193	235	318	452	559
Romania	.	211	552	971	1234	2449	4486	5521	6651	7098
Yugoslavia	.	.	.	.	.	749	853	968	900	1165
SEEC-8 [2]	4	655	1235	1869	3062	5412	9319	13641	15922	21100
Czech Republic	72	3423	4547	7350	8572	9234	14375	17552	21644	26764
Hungary	569	5585	7095	11926	14961	16086	18517	19299	19804	23562
Poland	109	2307	3789	7843	11463	14587	22479	26075	33603	36500
Slovakia	.	.	897	1297	2046	2083	2890	3188	4504	5730
Slovenia	.	954	1326	1763	1999	2207	2766	2617	2809	3400
CEEC-5 [2]	750	12259	17654	30380	38640	44197	61921	69771	82363	98777

Notes: 1) Estimates – 2) Sum of available data.

Source: National bank of respective countries and IMF.

The legal ground for such a role and function, to be performed as described, may be also found in the special legislation ruling the *Trieste Free Port Zones*, exempting the local Port activities from all levies, duties or tolls applied within the State but not directly related to effective services rendered, as originally agreed in the 1919 Saint Germain Agreement (Austro - Italian section of the Treaty of Peace of Versailles), reaffirmed by the Paris Treaty of Peace in 1947 (Annex VIII), readdressed in the London Italian - Yugoslavian Memorandum of 1954, inserted in 1975 in the Osimo Agreement, definetively reconciling all the Italian and Yugoslavian pending border's matters and in the consequent law n. 73/1977, establishing the provision of a transborder free zone under the same *legal status;* such transnational role has been recently reiterated in the foreword to the Italian law 19/1991, undergoing amendment processes in order to potentiate its cited Free Zone role as ultimately referred to in the UE Association of Slovenia Accord, art. 73-88-94-108, law 98/1998.

The special and potential status of the *Trieste Free Port Zones*, as extended and addressed specifically all through the border areas, by the Slovenia Accession Agreement, provides the related commercial, financial and indirect taxation facilities in an environment of easily enforceable international law covenants and procedures. At present, the income of the holding company activities within Italy and the *Free Port Zones*, is taxed, as previously said, at a rate of 1,80 % over foreign incomes and without any withholding taxation whenever expatriated to controlling entities residing outside the UE, the Italian Government has anticipated its decision to reduce it to 1,5% (35% of 5%) art. 96bis *TUIR* (Italian Taxing Code).

The Trieste Free Port Zones *Special Status* may provide a marketing, logistic and management Centre of industrial Outsourcing to Central and Eastern Europe Countries and to the local Free Zones to supply outsourcing processes from Western Europe, in first instance and from the Western Hemisphere in general.

The local existing logistic assets, the easily enforceable law and agreements against double taxation may all furthermore favour such a role, which reflects the previous logistic role empowered during the eighteen century and running up to the First World War. During this epoch the Joint Venture to cut the Suez Canal, one of the fist commodities future market for South American unwashed arabica coffee, the development of railways communication through the Alps, the Indian Ocean liners and the Insurance industry were all locally profitably developed in a first wave of globalization.

The whole area settings with the Slovenian joining of the UE are nowadays again promising and potentially even more suitable in this direction as a new high profile hub role in the North Adriatic System as outlined after almost one century of bulwark and stronghold iron gate functions.

All the Countries signing the Second World War Peace Treaty have recognized the special rule of the Trieste Free Port Areas, providing the extraterritorial status with free movement, activities and exemption from all excise or indirect taxation as stated in the VIII annexed to the treaty of peace of Paris 1947, and ratified by the Italian State with the law 2 August 1947, n. 811 asserting the exclusion of all barriers or quotas limitations over transiting goods and merchandise. The role of Netherlands appears as indicated in the above table.

Czech Republic: Inward Foreign Direct Investment Country, 1993 –2000
(In millions of U.S. dollars)

	1993	1994	1995	1996	1997	1998 *	1999 *	2000 *
Country								
Western Europe								
Belgium	32	33	25	57	56	47	1,378	113
Denmark	2	5	12	11	3	25	43	51
France	34	77	168	20	102	142	232	172
Germany	82	418	567	249	391	958	1,300	1,011
United Kingdom	0	38	53	84	196	347	104	130
Italy	**12**	**12**	**1**	**90**	**-36**	**27**	**47**	**80**
Netherlands	**30**	**6**	**736**	**259**	**134**	**838**	**1,131**	**1,006**
Austria	**55**	**80**	**87**	**208**	**95**	**415**	**833**	**938**
Sweden	12	19	22	56	89	-70	127	129
Switzerland	14	39	679	55	47	112	354	187
Canada	20	0	0	0	0	-5	11	120
United States	255	39	101	253	99	535	581	149
Japan	0	5	0	39	11	23	5	66
Other	106	98	111	47	113	324	179	443
Total	**654**	**869**	**2562**	**1428**	**1300**	**3718**	**6324**	**4595**

Source: Data provided by the Czech National Bank.

A similar potential logistic center may be attracting as a Netherlands headquarters location where Dutch tax authorities serve as business partners. For call centers, headquarters, distribution centers and other service operations, an *advance tax ruling* can be negotiated with the Dutch tax authorities. The Dutch Secretary of Finance has defined the concept of an advance tax ruling as a position *taken in advance by the tax inspector within the scope of the law, case law and regulations with respect to the tax consequences of specified activities in the Netherlands of associated enterprises.* The Ministry of Finance allows a set of *standard rulings* that deal with situations that frequently arise so as to make it possible to speed up the process of getting a ruling in common situations. In specific cases, however, a tailor-made ruling will be agreed upon. *Cost-plus rulings* give certainty about the *arms-length* - remuneration. A cost-plus ruling may cover activities that meet the following requirements:

- the absence of business risk;
- the set-up may not be unusual;
- the nature of the performed activities is auxiliary or supportive.

It is difficult to assess a normal profit for the activities concerned, such as trading, counter trading, adaptation, warehousing, finishing and assembling specially in the case of the intercompany nature of the transactions evolved.

Cost-plus rulings may be arranged for headquarter, distribution, auxiliary or supportive activities. As the Dutch operations in these cases have the character of a cost center rather than a profit center, the corporate tax is levied over a mark-up on total operating cost (the cost base). This cost base comprises total costs for labor, rent, depreciation, services for third parties (accountants, labor agencies), notional interest and interests on loans. The mark-up (the "plus") depends on the level of activities that are carried out. In most cases, it will vary between 5% and 12.5%.

Outsourcing is one of the best way to get ready for interbusiness transactions and the Free Zones are the best in the logistic planning.

The industrial revolution has changed the 19th century, commerce and e-commerce altered the 20th now, in the 21st century, business to business e-commerce is transforming the way companies interact and intercompany relations. Some research estimates interbusiness transactions e-commerce in the U.S. will total $2.7 trillion by the end of 2004. National boundaries are becoming blurred as the Internet provides a speedy and cost-effective way to outsource with companies halfway around the globe. Buying consortiums are springing up to aggregate volumes; this lowers the cost of goods for buyers and creates new market opportunities for suppliers. To get ready for the new interbusiness revolution, many companies have to reinvent their business processes.

Outsourcing finance and accounting has many advantages as well, besides enhancing business focus, outsourcing "the books" helps companies to control cost structure, installs discipline into the finance and accounting process, and give them access to the finest finance and accounting professionals and technology available in the marketplace.

Outsourcing may be the only way a mid-market company can use world class financial and industrial applications. As one can't afford to use them outright, so he turns to an outsourcing provider who only charges on a per use basis. That way mid-size companies get the benefits they want at a price they can afford with a wide choice of alternatives. The delivering Country has different options in order to arrange the formal shipment of such materials, it may be a final sale, a temporary export a deliverance with ownership titles of goods to be transformed with an invoice, a memorandum list or similar documents indicating the purpose of the shipment, the nature of the goods and their final destination.

The only relevant issue in this phase is the added value labelling and the consequent importation duties and taxes and the related export - import base.

Since the difference in the cost of labour and associated fringe and social benefits is comparable lower in Central and East Europe and LDs Countries, the normal importation duties are irrelevant in the overall final cost of the goods operated in such areas.

Foreign direct investment has also been a common source of discussion and consideration and different approaches on globalization with regard of mature economic systems: US companies allegedly *exporting jobs* to Mexico by setting up factories, or the purchase of Hollywood studios by foreigners paying lower wages Japanese, Australian or Canadian companies.

The *Outward Forwarding Industrial processes*, are included in a peculiar EU rule providing specific Custom treatment to the shipments of goods and raw materials to be finished or semi finished under production license or self-directed manufacturing stages by foreign entities or permanent local establishments and sequentially reimported.

According to the art. 145 - 160 of the European Custom Code and in accordance with the specific rule 2913/92/CE and 2454/93/CE, such peculiar industrial phases are to be considered irrelevant in term of value in term of final merchandise added-value base but are reckoned as simple cost of production at border line point.

An industrial accounting framework might eventually provide all the elements in order to face the EU importing Country value assessment and meet only those levies that are related to the cost of assembling and finishing, being irrelevant in any case the final product value as custom rates are not applicable.

Such a pattern is still lower than earliest levels of net capital outflows from Germany or Japan - the two biggest capital exporters of recent years - never topped five percent of their

GDP, compared to the peak 8-9 percent of GDP that Britain, France, Germany and the Netherlands were investing in the US, Canada, Australia, Argentina and other countries in the half-century before World War I. Increased openness to foreign investment is really a case of going planning back to the future.

Across the world Swedish Keynesianism is not working very well any more, due to the global economy: global growth is held hostage to creditors and financial intermediaries operating from almost every angle over the web.

Countries with good wages and relative expensive social outlays risk to find themselves priced out of the new emerging and consolidated markets, which circumstance leaves room to developing areas and over innovated technologies.

Accepting a downward convergence of wages and benefits, or a higher unemployment rate, seems to be an inevitable price to be paid as a trade off with the *efficiency* of the global market where only productivity may offset the open competition over the most valuable asset which nowadays has become cheap and skilled labour.

New American liberals and European social democrats have not defied the neo-liberal point assuming that all prices are efficiently set by market forces. Yet there is a surprisingly strong dissent stemming from major Unions who assume that some kind of tariff protectionism might still be imposed, and the EU must acclimatize to the new realty not yet fully understood by most of the activists of the world wide social progress.

The outsourcing process is the only way to a fast economic integration and the Free Zones structures may conduct a leading role toward a single European fully open market contemplating the closer candidates and the likely evolving market structure.

Economists as Jeffrey Sachs of Harvard, Paul Krugman of MIT, Barry Eichengreen of Berkeley California, Joseph Stiglitz, chief economist of the World Bank, and Jagdish Bhagwati of Columbia, formerly economic advisor to the Director-General of the GATT, have all challenged whether free flows of capital and laissez-faire setting optimise general economic outcomes the magnitude of the mankind population is the best answer to the economic aspect of modern industrialization.

The 1990s have been a decade of disturbances in international finance, beginning in Europe in 1992, followed by Mexico in 1994-95, culminated by East Asia in 1997-98, Russia in 1999, Argentina this year, and perhaps Brazil in near future.

Developing countries have increasingly and gradually benefited from the inflows of capital, the investments that have propelled their growth have infrequently originated from their own internal savings.

Capital flows from the world economic core to the periphery, only $150 billion a year in the 1990s, have been less than 15 percent of their investment and less than 5 percent of the saving of the developed mature economies. These shares are much smaller than comparable figures before the year 1914, when during the first globalization they were more than double being both close to 50 percent.

Capital has gained great mobility and labour should not impose large mass migration as now has happened since the collapse of the Berlin wall and the Shengen enlargement.

There is, of course, no global authority to regulate and manage the new scenario worldwide; global laissez faire tends to price out of world markets nations that elect to hang on to policies of high wages and generous social benefits. It pulls capital into corners of the globe where there is less regulation, which in turn makes it harder for the advanced nations to police their banks, stock exchanges, capital markets, and achieved social standards.

Globalism also influences the domestic political balance in favour of the forces that want more globalism. Labor and social democratic parties seem unable to deliver the benefits they once did of secure jobs, high and rising earnings, good social benefits.

Working people either stop voting, as they do in the U.S. and in Europe, or they, internalize the values of the new economy and conclude that the lower economic horizons are their own problem.

In this general perspective, the mechanism of Free Zones provide a transient instrument in order to coordinate and monitor the levelling of the economic homogenisation and development leaving room to the more stringent issue linked to the overpopulation in a high level and standards consuming society.

In Europe, specially, the free zones and the forward outwarding processes represent a large opportunity to slowly and positivesly integrate the continent economies with their huge discrepancies and inequalities and lesse tensions originated by large differences in per capita income in a transparent world where room scems to become smaller and demand of higher and differenziate.