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	<p>RESEARCH ARTICLE </p>
	<p><b>Free Zones as Strategic Instruments for Attracting Foreign Direct Investment: A Legal–Economic Assessment of Incentives, Governance Frameworks, and the Egyptian Experience</b></p>
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<p><b>Abstract</b></p>	
<p>Free zones have emerged as one of the most effective policy instruments employed by states to enhance their attractiveness to foreign direct investment (FDI), stimulate exports, and integrate national economies into global value chains. Through preferential regulatory regimes, tax incentives, and customs facilitation mechanisms, free zones seek to create a competitive investment climate that compensates for structural and institutional constraints often present in developing economies. This study aims to examine the role of free zones in attracting foreign investment through an integrated legal and economic analysis of international agreements, national legislation, and administrative practices. Particular emphasis is placed on the Egyptian experience, which represents one of the most prominent and relatively successful models in the Middle East and North Africa region. The research adopts a descriptive–analytical methodology supported by a case study approach, enabling an in-depth evaluation of incentive structures, governance mechanisms, and regulatory coherence within Egyptian free zones. The findings indicate that while free zones play a critical role in mobilizing foreign and domestic capital, their effectiveness largely depends on the clarity, stability, and consistency of the legal framework governing investment activities. The study highlights the need to harmonize legislative texts, strengthen institutional coordination, and modernize administrative procedures in order to enhance transparency and reduce transaction costs for investors. Furthermore, it underscores the importance of reassessing the geographical distribution and strategic orientation of free zones to better align them with evolving global market dynamics and international trade networks. The paper concludes that free zones, when embedded within a coherent national development strategy and supported by efficient governance structures, can serve as powerful catalysts for sustainable economic growth, technology transfer, and employment generation.</p>	
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**Introduction:**

Free zones are among the most prominent economic tools used by countries to promote trade and investment. They provide an ideal environment for business and possess special legal and administrative characteristics designed to attract local and foreign investors by offering various incentives such as tax exemptions and customs facilities.

In light of global economic challenges, free zones have become pivotal in achieving sustainable economic growth. They contribute to increased productivity and boosted exports, and play a significant role in job creation and stimulating innovation.

This article will examine the impact of free zones on foreign investment through a case study of the Egyptian experience. We will address this in three main sections:

Section 1: The nature of free zones

Section 2: The factors and obstacles affecting foreign investment

Section 3: A case study of the Egyptian experience in attracting foreign investment to free zones.

**1. First Axis: The Nature of Free Zones:****1. Definition of Free Zones:**

There is no single, unified definition of a free zone. Examining the various legislations regulating free zone operations worldwide, we find that they do not provide a specific definition of a free zone. Instead, they define the zone's boundaries, the customs procedures and regulations governing operations within the free zone, or the areas of activity that can be practiced within its boundaries, as well as the objectives behind its establishment.

A free zone is defined as "an area where industrial, service, or commercial activities are practiced, located within a defined area. Its boundaries may include an airport, national property, or be located near a port, airport, or industrial zone. Investment in free zones grants the investor the right to tax and customs privileges (Kourboua, 1999)." Algerian legislation, according to Executive Decree 94/320 dated October 17, 1994, defines free zones as areas with industrial, service, and commercial activities, located within a defined area. Its boundaries may include an airport, national property, or be located near a port, airport, or industrial zone. Public authorities exercise the powers of the state over airports and ports (Ali & Madani Ahmed).

The essential elements of the free zone definition can be summarized as follows:

- A geographical area located on or near the borders, port, airport, or any part of the state's territory.
- Not subject to the customs or tax laws of the host country.
- Commercial, industrial, and service activities are practiced within it.

**2. Characteristics of Free Zones:**

Free zones are based on a set of characteristics, summarized as follows:

- The geographical area of the free zone is defined.
- Free zones are usually established by legislation or decree, but may also be established without such authorization.
- The free zone is customs-isolated from the rest of the host country's territory.
- The free zone is isolated from the rest of the host country's territory, and this isolation may be achieved through fences or by means of measures that control or administratively regulate entry.
- The free zone is subject to the full sovereignty of the host country.
- Free zones are managed by governmental bodies or specialized agencies appointed by the state for this purpose. These agencies manage operations within the free zones.
- Tax and customs exemptions and incentives, as well as procedural facilitations, are granted in free zones to encourage and attract investment.

**3. Importance and Objectives of Free Zones:**

**Importance of Free Zones:** The economic importance of free zones stems from their role as a means of responding to regional and global changes. It has become widely accepted that no country can exist in isolation from current events and

rapid changes. The philosophy of free zones, which emphasizes increased economic openness, stimulates trade, and facilitates the movement of capital between countries, leads to the establishment of joint free zones that yield economic and political benefits for the countries that create them. The importance of free zones has increased further when they allow for manufacturing operations. Large factories, often branches of giant industrial companies, are established within these zones. These factories import goods and raw materials in semi-finished stages, then reprocess and assemble them within the free zone (Ali & Madani Ahmed, 2006).

#### 4. Objectives of Free Zones: The objectives of free zones are as follows:

- To promote exports, increase net capital formation, and foster regional industrial development.
- To attract transit trade to the free zone, transforming it into a hub for re-export to various countries worldwide.
- To accelerate economic growth and contribute to alleviating the balance of payments deficits faced by host countries.
- Creating new job opportunities and contributing to combating unemployment by generating employment in industries and companies located within the free zone.
- Transferring modern technology, which leads to increased efficiency and skill among the local workforce, thus contributing to raising the level of local industries and giving them a competitive edge.
- Providing a strategic reserve of essential commodities during peacetime and preventing shortages of these materials during times of force majeure or emergencies.
- Free zones encourage host countries to leverage their geographical location by establishing industries, warehouses, markets, and commercial centers, thereby becoming a global trading hub for trade with other countries.
- Utilizing local resources, which boosts trade activity in the country, in addition to stimulating the transportation and services sectors.

Most countries grant customs and tax exemptions when establishing free zones within their territories. These exemptions vary from one country to another, and their purpose is to attract foreign and domestic investment.

#### 5. Types of Free Zones:

Free zones have diversified in form, reflecting the variety of activities and projects established within them. These can be categorized as follows:

- **Comprehensive or Multi-Project General Free Zones:** These include (Khrouf, April 28-29, 2017):
- **Free Cities and Ports:** This type of free zone has expanded due to its geographical location along international trade routes. Its operations have evolved from transit trade, warehousing, sorting, packaging, shipping, and re-export activities to industrial and other activities, particularly in free cities. This is due to the diversity of infrastructure and services available, as well as the conducive environment for economic activities.
- **Commercial Free Zones:** These are traditional free zones that have grown and developed alongside the growth and development of international trade. Their activities involve importing goods and products from outside or within the host country for storage and subsequent sale. This includes simpler processing such as packaging without altering the essential nature of the goods and products, followed by export abroad or domestically if there is demand.
- **Industrial Free Zones:** The number of these zones has increased due to the diversification of national needs and the pursuit of greater economic and social gains. The industrial processes established in these zones involve several fundamental transformations, such as conversion, completion, assembly, or refining, followed by export or use to meet domestic demand.
- **Commercial/Industrial Free Zones:** This is one of the newest types of free zones, combining elements of commercial and industrial free zones. It can also be called comprehensive free zones. These zones require relatively large areas due to the scale and variety of projects established within them, along with the necessary infrastructure, incentives, and other facilities. These zones are among the most attractive areas for local investment.
- **Special Economic Zones:** These are free zones within free cities. They are not closed areas but rather integrated cities or districts with the typical characteristics of a community. These zones differ from other free zones in their centralized administration, which allows for investment decisions to be made outside the state's jurisdiction. They are also permitted to develop their own infrastructure, provided they can generate revenue from fees and profits of companies that own them partially or wholly.

- **Private Free Zones:** These are projects that are treated as free zones in terms of customs and taxes, exempt from regulations and laws, regardless of their location or ownership. The state is not obligated to provide them with the services it provides to other free zones.

## Second Axis: Factors and Obstacles Controlling Foreign Investment

### I. Factors for Establishing Free Zones: Free zones have several essential factors that must be present, namely:

1. **Political and Security Factors:** Undoubtedly, establishing any free zone is a political decision or a political will before it is an economic or legislative decision. It requires alignment of interests and policies between the host country and the international companies invited to invest in the proposed free zone, as most foreign direct investment flows come from multinational corporations. This decision also requires political and economic readiness on the part of the country's political leadership to relinquish some of its sovereign rights in parts of its territory (free zones), whether these rights relate to taxes and customs duties or other economic laws and regulations that conflict with investment laws in free zones. In addition to political stability, a suitable investment environment requires sovereignty in some practices. Furthermore, the host country must have stable security and good relations with neighboring countries, as most transactions in free zones are international transactions.
2. **Economic and Administrative Foundations:** These include a long-term investment planning strategy to provide a stable and intervention-free economic environment, effective financial controls and a robust financial system for monitoring the various financial institutions within the free zone, free from bureaucracy and impulsive, ill-considered decisions, stable and well-defined investment legislation, regulations, and laws, and a state with an independent vision regarding economic objectives and development paths to protect investors from sudden fluctuations and crises that affect the national economy and negatively impact investors in free zones.
3. **Geographical and Environmental Foundations:** Most free zones are concentrated in or near ports, airports, or borders, close to regional or international markets, or in strategic locations overlooking major markets. This aims to reduce transportation costs and facilitate production processes, the distribution of goods or services, and their export to key regional and global markets. Furthermore, most foreign companies prefer to establish themselves in areas with relatively moderate climates and environments.
4. **Human Resources:** Skilled and qualified labor must be available to work in companies and investment projects established in relatively cheap free zones. There are two essential complementary factors that are of great importance in evaluating the workforce from the perspective of international companies, namely skills and flexibility in decision-making.

### II. Obstacles to the Success of Free Zones: There are several obstacles, which we will address below (Hafid, Omar, & Ibrahim Fattouh, 2019):

#### 1. Economic and Financial Obstacles: These include:

- The lack of clarity or transparency in the host country's policy and strategy regarding free zones, leading investors to be cautious and avoid any sudden measures taken by the state concerning these zones.
- The economic instability of the host country.
- The inability or reluctance of host country institutions to provide loans to projects operating in free zones.

#### 2. Legislative and Judicial Obstacles: Investment is closely linked to legislation. The incentives, facilities, and guarantees for local and foreign investments are determined by different laws. Some obstacles related to legislation and the judiciary can be summarized as follows:

- The incentives, facilities, and guarantees for local and foreign investments vary depending on the legislation.
- The multiplicity of laws regulating investment in free zones

#### 3. Administrative obstacles: These include:

- The multiplicity of entities overseeing investments in the country and the duplication of their jurisdictions. Government bureaucracy, which investors face when licensing their projects or in other procedures, wastes their time.

#### 4. Labor-related obstacles: These include:

- The negative impact of some labor union practices, which distract investors from developing production and operations.
- The lack of sufficient, affordable, and skilled labor in host countries.
- The constant changes and amendments to investment laws, both within and outside free zones, create a state of perpetual anxiety for investors regarding the future of their investments in free zones.

5. **External obstacles:** The most significant of these obstacles are (Belkacem & et al, 2019):

- Economic blocs and the impact of some member states' dealings on goods produced in free zones hosted by these blocs. Free zones established in countries belonging to economic blocs often suffer from the non-recognition of products from the country of origin by other member states within the same blocs.
- The support provided by some countries to certain industries affects similar industries in free zones due to the lack of fair competition.

### Third Axis: A Study of the Egyptian Experience in Attracting Foreign Investment in Free Zones

I. **The Emergence of Free Zones in Egypt:** Egypt was introduced to the concept of free zones in the second half of the twelfth century when Alexandria was a center for trade between Europe and Asia. In the modern era, the first free zone in Egypt was established in 1902 when the Egyptian government concluded an agreement with the Suez Canal Company. This agreement established a land and sea free zone attached to Port Said to serve the company's purposes and to expand and maintain the port. Under the agreement, the company was granted customs exemptions for all goods entering the zone.

It is clear that the concept of free zones has evolved globally in terms of location. Previously, they were located near or within seaports, but now they are located near airports or within the country to develop remote areas. They have also evolved in terms of the type of activity and purpose, from simply being areas where commercial projects were granted certain privileges to stimulate transit trade, to zones where various operations are carried out, ranging from storage and simple manufacturing to heavy manufacturing, as well as service activities. These free zones were initially established more to serve the interests of colonial powers than as tools for socio-economic development in developing countries. They have also undergone significant expansion in size; whereas they were once confined to limited areas, they now occupy vast expanses, even encompassing entire cities or ports. In this way, free zones have recently taken their modern form, becoming industrial export hubs. The range of privileges and exemptions granted to these zones has also increased considerably. Driven by the desire to attract capital to operate within free zones, countries are now competing to offer various incentives and exemptions for investment (El-Sahrawi, 1980).

## II. Types of Free Zones in Egypt:

Free zones are divided into two main types: public free zones and private free zones.

1. **Public Free Zones:** These are areas under state sovereignty, usually located at one of its sea, land, or air ports, and are demarcated by fences to separate them from the rest of the country. A public free zone includes a group of investment projects established to benefit from the incentives and advantages of investing in this area. The state provides the necessary infrastructure for conducting business within this zone.

There are nine public free zones in Egypt, geographically distributed as follows: Alexandria (Amreya), Cairo (Nasr City), Port Said, Suez, Ismailia, Damietta, the Media Zone in 6th of October City, Shebin El-Kom (Menoufia Governorate), and the Qift Free Zone (Qena Governorate). With the exception of the Media Zone, Egyptian public free zones are not specialized. Each free zone includes a number of storage, industrial, service, and financial projects, without being limited to a single activity (General Authority for Investment and Free Zones, 2015).

2. **Private Free Zones:** These are limited to a single project only if the nature of the project necessitates it, such as when the project's location significantly impacts its economics (e.g., proximity to raw material sources), or when the location aligns with the nature of the activity, such as maritime transport projects or cement silos. Other reasons include the project requiring a large enough area that cannot be accommodated in a public free zone, the project causing environmental pollution that necessitates its establishment in a private zone, or the project contributing to the development of a new urban area according to the state's plan. Projects established under this system enjoy the same advantages, incentives, and guarantees as projects established in public free zones. Administrative oversight is provided by the nearest public free zone. Any project can transition to operating under the private free zone system, provided it has already commenced operations and its exports constitute at least 50% of its production (State Information Service, 2003).

3. Free zones are considered a distinguished investment model under which you can establish, operate, and run your project. The provisions of Investment Guarantees and Incentives Law No. 72 of 2017 and its executive regulations remain in effect.

### 4. Advantages and Guarantees Granted in Free Zones in Egypt:

Advantages, guarantees, and exemptions granted to projects established in free zones, as stipulated in Investment Law No. 72 of 2017.

#### a. Advantages:

- Freedom to transfer invested capital and project profits abroad.
- Freedom to choose the investment sector and the legal structure of projects.
- Freedom to set product prices and profit margins.
- No minimum or maximum limits on invested capital for projects in public free zones only.
- No limits on capital calculation; foreign investors can invest independently or participate in any percentage of the investment, except for projects established in Sinai.
- The possibility of operating on behalf of others and utilizing the project's capacities according to the rules approved by the Authority in this regard.
- Granting foreign investors residency facilities.
- Granting foreign workers residency permits upon the project's request.

**b. Guarantees:**

- No legal action may be taken against projects operating within the free zone system without prior authorization from the Authority.
- Projects and facilities may not be nationalized or confiscated.
- Projects may not be placed under administrative receivership, have their funds seized, confiscated, frozen, or impounded except through judicial channels.
- All capital assets and production inputs necessary for the project's operations, excluding passenger vehicles, are exempt from any customs duties, sales taxes, or other taxes for the duration of operations, even if the nature of the activity requires their temporary location outside the free zone.
- The project's exports and imports to and from the country are exempt from any customs duties or taxes, whether sales taxes or other applicable taxes or fees within the country.
- The project and its profits are not subject to any applicable tax or customs laws or regulations within the country during the period of operations.
- The project's imports from the local market are not subject to value-added tax.
- Goods in transit with a specified destination are exempt from any applicable entry and exit fees, subject to the following conditions:
  - The project must be located within the customs zone.
  - The final destination must be clearly stated on the bill of lading and invoice.
- Locally sourced components of goods produced in projects and free zones are fully exempt from customs duties for goods destined for the local market.

**5. Free Zones System:**

The free zones system in Egypt is considered one of the most distinctive investment models, contributing to the following:

- Attracting more investments, both local and foreign.
- Increasing exports, boosting GDP, and creating more job opportunities.
- Developing the Egyptian national economy by establishing numerous export-oriented industries within the free zones.
- Attracting cutting-edge technologies, creating new job opportunities, and increasing foreign currency reserves.
- Allowing the host country to establish direct connections with companies in other countries worldwide, along with preferential treatment regarding import regulations, customs procedures, and financial transactions compared to other investment systems. Projects within free zones and the profits they distribute are not subject to the provisions of the tax and duty laws in force in Egypt.

However, these projects are subject to the following treatment (General Authority for Investment Egypt):

Projects in public free zones are subject to a 2% duty on the value of goods upon entry (CIF) for storage projects and a 1% duty on the value of goods upon exit (FOB) for manufacturing and assembly projects. Transit goods with a specified destination are exempt from this duty.

A 1% duty is levied on the total revenues generated by projects whose main activity does not involve the import or export of goods, based on financial statements certified by a licensed accountant.

Projects in private free zones are subject to a 1% duty on the total revenues generated by manufacturing and assembly projects when exporting goods outside the country, and a 2% duty on the total revenues generated by these projects when goods enter the country. Transit goods with a specified destination are exempt from this duty.

A 2% duty is levied on the total revenues generated; This is in relation to other projects mentioned in the previous clause.

### **Conclusion:**

Free zones can be considered effective tools for promoting economic growth and developing global trade. This article has reviewed various aspects of free zones, from their definition and functions to their benefits and the challenges they face. From this study, we can conclude the following key points:

- Free zones significantly contribute to stimulating the economy by attracting foreign direct investment, thus boosting economic activity.
- They serve as platforms for exporting products, contributing to improving a country's trade balance.
- Free zones contribute to job creation, reducing unemployment rates and improving living standards.
- Infrastructure development: Free zones require investments in regional infrastructure.
- Challenges: Despite their numerous benefits, free zones face some challenges, such as competition between countries and regulatory oversight.

### **Recommendations:**

- Strengthening policies: The government should establish clear policies to support free zones and simplify procedures.
- Developing skills: Investing in workforce training is crucial to ensure the availability of the necessary skills to support industries within free zones.
- Encouraging innovation by registering innovation and technology in free zones to enhance competitiveness, as free zones represent a real opportunity for countries to achieve economic development. Success in this field requires concerted efforts between governments, the private sector and civil society to achieve the desired goals.

### **Ethical Considerations**

This study is based exclusively on the analysis of publicly available legal texts, policy documents, official reports, and academic sources. It does not involve human participants, personal data, or experimental procedures. Consequently, ethical approval and informed consent were not required for this research. The authors confirm that the study was conducted in accordance with accepted standards of academic integrity and research ethics.

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### **Conflict of Interest**

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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