Interpreting the Kobe Enterprise Zone as an Import and Investment Promotion Device

Toshihisa TOYODA*

I. Introduction

Although Japan has implemented a number of measures to facilitate imports, her external account surplus remains relatively high. After the current account recorded its large amounts of 14.7 trillion yen in 1993, the values have declined to 7.2 trillion yen in 1996. But, the values are still comparatively high and are expected to expand again in 1997 due to the recent depreciation of the yen. In this paper an experimental scheme for promoting imports and inward foreign direct investment will be examined. Specifically, the “Enterprise Zone” concept recently proposed by Hyogo Prefecture and Kobe City will be examined with special references to its meaning, its difference from enterprise zones in other countries and its international implications.

We stress that this enterprise zone experiment will not only help to liberate the area affected by the Great Hanshin-Awaji Earthquake from its stagnant economic situation but will also have an important influence on Japan’s strategic role in APEC.

II. Foreign Access Zones and Their Role in Japan

The Japanese economy has traditionally heavily depended on foreign resources and energy supplies so that the importing primary products has been, and remains, of vital importance. Recently, however, imports of manufactured goods and parts have been gradually increasing, the latter being the result of out-sourcing.

Further import facilitation is necessary for several important reasons. First, Japan hosted the APEC leaders’ and ministerial meetings in Osaka in November, 1995. After

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much political discussion, they led to the action plan to follow up the “Bogor goals” to achieve free trade in the Asia-Pacific region by 2020, with developed economies aiming to do so by 2010. As a key trading partner of the US, Asian and other countries in the region, Japan is expected to demonstrate a clear policy for further liberalizing trade and investment. Import facilitation will be a very visible device for that purpose. (See, e.g., Miyaji and Ohnishi (1995; pp.204-207)).

Second, although Japan’s current account surplus has been declining during the last 3 years, it still reached the substantial figure of US $123 billion for FY1994 and was also around US $120 billion for FY1995. This is the biggest surplus not only in the APEC region but also in the world as a whole. Import promoting is necessary if Japan is to reduce her current account surplus. Trimming the current account surplus will also help Japan’s exchange rates stabilize.

Third, the facilitation of more imports will benefit Japan’s consumers. As traditional trade theory tells us, the gains from trade should be the welfare gains of consumers in importing countries, under certain conditions. If some impediments to international economic transactions, i.e. tariff and non-tariff barriers, exist, not only producers in exporting countries but also consumers in importing countries lose welfare. In the case of Japan, tariff rates for almost all imported goods are quite low, particularly for manufactured goods and natural resources, as Figure 1 shows. The exceptions are mainly food products, e.g. rice, wheat, other grains, meat and milk products etc., and also some apparel products to a lesser degree. Although, following the Uruguay Round tariff rates have gradually been reduced, those for food products are still quite high; in fact, that was politically the most sensitive issue at the Osaka Summit. Invisible impediments (or non-tariff barriers) to trade also exist, including language, standards, administrative procedures, commercial legislation and regulations etc.
Figure 1
Average Tariff Rate of Japan, by Products, 1993 and 1995

It is commonly believed that the prices of many goods and services in Japan are significantly higher than in other countries because of various impediments to trade, in addition to relatively high factor costs. It will not suffice to attribute all the differential between the prices of domestic and foreign goods to trade impediments because they may not be perfect substitutes, for example, they may not be the same quality. We therefore use price wedges or tariff equivalents associated with non-tariff barriers to measure their import restrictiveness. Table 1 shows one example of the measurement of price wedges or import tax equivalents derived from a model incorporating the relevant responses of supply and demand to price changes; the figures show estimates of the price impact of the level of tariff protection and other producer price support measures. As can be seen from the table, in the case of Japan, primary and processed food along with some apparel products are comparatively highly protected, although the overall level of protection is relatively low compared with that of the other APEC economies. It is true that the prices of the products associated with higher import tax equivalents are higher than in other countries. Note that Table 1 does not show the import tax equivalents for services; service prices are admittedly quite high in Japan. Consumers will be better off if they can obtain cheaper, foreign goods and services more easily.
Table 1
Average Import Tax Equivalents in Selected APEC Economies\(^a\) (%)

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Canada</th>
<th>United States</th>
<th>Japan</th>
<th>NIP(^b)</th>
<th>ASEAN(^c)</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary production</td>
<td>4.9</td>
<td>3.5</td>
<td>18.8</td>
<td>8.3</td>
<td>97.9</td>
<td>33.4</td>
<td>6.6</td>
<td></td>
</tr>
<tr>
<td>Resources</td>
<td>0.3</td>
<td>0.3</td>
<td>0.1</td>
<td>0.6</td>
<td>0.8</td>
<td>13.7</td>
<td>4.7</td>
<td></td>
</tr>
<tr>
<td>Processed food</td>
<td>7.3</td>
<td>11.9</td>
<td>13.9</td>
<td>11.2</td>
<td>36.3</td>
<td>22.5</td>
<td>10.1</td>
<td></td>
</tr>
<tr>
<td>Petroleum and coal products</td>
<td>1.3</td>
<td>8.5</td>
<td>1.7</td>
<td>1.7</td>
<td>0.3</td>
<td>4.8</td>
<td>5.3</td>
<td></td>
</tr>
<tr>
<td>Non-metallic mineral products</td>
<td>17.3</td>
<td>23.3</td>
<td>10.9</td>
<td>9.8</td>
<td>3.5</td>
<td>30.3</td>
<td>10.2</td>
<td></td>
</tr>
<tr>
<td>Primary iron and steel</td>
<td>13.7</td>
<td>15.9</td>
<td>11.6</td>
<td>10.0</td>
<td>4.0</td>
<td>8.3</td>
<td>9.1</td>
<td></td>
</tr>
<tr>
<td>Non-ferrous metals</td>
<td>9.7</td>
<td>11.8</td>
<td>6.2</td>
<td>3.9</td>
<td>1.3</td>
<td>6.0</td>
<td>10.5</td>
<td>5.9</td>
</tr>
<tr>
<td>Fabricated metal products</td>
<td>19.7</td>
<td>31.3</td>
<td>8.9</td>
<td>7.7</td>
<td>4.2</td>
<td>10.2</td>
<td>24.0</td>
<td>15.2</td>
</tr>
<tr>
<td>Textiles</td>
<td>15.2</td>
<td>16.0</td>
<td>19.1</td>
<td>9.8</td>
<td>7.2</td>
<td>7.6</td>
<td>36.4</td>
<td>25.3</td>
</tr>
<tr>
<td>Wearing apparel</td>
<td>10.3</td>
<td>69.8</td>
<td>23.8</td>
<td>0.8</td>
<td>14.0</td>
<td>7.3</td>
<td>44.7</td>
<td>4.9</td>
</tr>
<tr>
<td>Leather, fur, etc.</td>
<td>17.4</td>
<td>38.7</td>
<td>18.6</td>
<td>7.2</td>
<td>15.1</td>
<td>10.5</td>
<td>36.0</td>
<td>6.8</td>
</tr>
<tr>
<td>Lumber and wood products</td>
<td>17.8</td>
<td>29.5</td>
<td>9.3</td>
<td>3.5</td>
<td>4.7</td>
<td>8.7</td>
<td>47.8</td>
<td>11.6</td>
</tr>
<tr>
<td>Pulp, paper and printing</td>
<td>9.3</td>
<td>23.9</td>
<td>6.7</td>
<td>0.7</td>
<td>2.5</td>
<td>3.5</td>
<td>12.5</td>
<td>12.8</td>
</tr>
<tr>
<td>Chemicals, rubber and plastics</td>
<td>17.5</td>
<td>15.5</td>
<td>10.6</td>
<td>10.8</td>
<td>5.5</td>
<td>7.5</td>
<td>19.2</td>
<td>9.7</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>18.2</td>
<td>32.2</td>
<td>7.8</td>
<td>3.8</td>
<td>3.0</td>
<td>11.7</td>
<td>26.7</td>
<td>19.5</td>
</tr>
<tr>
<td>Other machinery and equipment</td>
<td>19.2</td>
<td>26.8</td>
<td>8.8</td>
<td>16.7</td>
<td>3.4</td>
<td>8.1</td>
<td>20.5</td>
<td>12.0</td>
</tr>
<tr>
<td>Other manufacturing</td>
<td>17.1</td>
<td>35.6</td>
<td>10.6</td>
<td>7.1</td>
<td>4.9</td>
<td>4.8</td>
<td>26.3</td>
<td>13.4</td>
</tr>
</tbody>
</table>

Notes: \(^a\)Import tax equivalents are the differences between domestic and border (CIF) prices expressed as a percentage of the border price.

\(^b\)Chinese Taipei, Singapore and Korea.

\(^c\)Indonesia, Malaysia, the Philippines and Thailand.

The relativities between various forms of impediments (e.g. tariffs and producer subsidies) are unlikely to have changed significantly between the late 1980s and the early 1990s.


Fourth, Japan should promote more imports of services. Figure 2 shows the services trade as a percentage of the total trade of the APEC countries. Japan’s trade in services is about 20% of her total trade, which is around the APEC average. Figure 3 shows service industries as a percentage of the total stock of inward foreign direct investment, from which we can observe that the figure for Japan is around 30%. Taking into consid-
eration the fact that total FDI into Japan is relatively small, the actual value of Japan's inward FDI in service industries is too small for a giant trading country. The average labor productivity in the service sector in Japan is relatively low and some room for, or necessity of, promoting imports and inward FDI of service industries exists.

Figure 2
Services Trade as a Percentage of Total Trade, 1985 and 1993

III. Outline of Foreign Access Zones

1. Main Contents

Foreign access zones (FAZs) have been created to facilitate imports, particularly imports to local areas in Japan. The so-called Import Promotion / Foreign Investment Law, in precise terms, "Law on Extraordinary Measures for the Promotion of Imports and the Facilitation of Foreign Direct Investment", was passed in July, 1992. Preceding this, Japan’s Cabinet had declared an action program for Japan’s global partnership in January 1992, in which the establishment FAZs had been mentioned.

The main contents of the provisional measure consisted of the following:

First, the so called “3rd sector” or quasi-public corporations (sometimes with private developers) were to build infrastructure such as (1) facilities to support the distribution of imported goods (i.e. facilities for storage and distribution), (2) those for supporting import-related businesses and (3) those for processing imports and selling by
wholesalers.

Second, the 3rd sector corporations (sometimes with private developers) were to offer services to expand and facilitate imports by providing information related to imports, import-related equipment leases, and managing imported cargo etc.

Third, the authorities were to support enterprises which use this infrastructure if their activities contributed to import facilitation.

2. The FAZ Approval Process

The approved process has the following features:

(a) Criteria for location

To be approved as a FAZ, an area must satisfy the following three conditions:

(1) It should be situated in or near a harbor or airport;

(2) Imported goods have been, or will be, handled to a significant degree in the area; and

(3) Import promotion will clearly be enhanced by FAZ facilities.

Import promotion will certainly be enhanced with FAZ facilities.

(b) Setting guidelines

The related ministries, i.e. the Ministry of International Trade and Industry (MITI), the Ministry of Transport, the Ministry of Agriculture, Forestry and Fisheries and the Ministry of Home Affairs should prepare guidelines.

(c) Planning Procedures

Prefectures or the 12 large cities declared by the government ordinance should prepare related plans according to the guidelines set by the ministries.

(d) Approval by the ministries

These plans should be approved by the related ministries.

3. Privileges for FAZs

(a) The following privileges were given to the 3rd sector and cooperating developers:

(1) Capital investment and debt assurance will be guaranteed by the Industry Infrastructure Fund;

(2) 5% of construction costs will be provided as a subsidy;

(3) A special allowance for depreciation of buildings and attached equipment (the rate of depreciation equals 12%) and reduction of local taxes will be permitted;

(4) Loans from the NTT Fund will be approved of up to 50% of the total loan;
(5) Loans from the Japan Development Bank together with the NTT Fund will be approved of up to 70% of the total loan; and

(6) Loans from the Small Business Cooperative will be approved to related small and medium-sized enterprises of up to 70 or 80% of the total loan at low interest rates.

(b) As a privilege for business activities promoting the handling of imported goods, loans from the Japan Development Bank will be approved of up to 50% of the total loan, at low interest rates.

(c) JETRO (the Japan External Trade Organization) will set a supporting center for FAZs and offer various business-supporting activities.

4. The "Comprehensively-Bonded" Area System

The Customs Act was amended in 1992 to create comprehensively-bonded areas. If an area is recognized as being "comprehensively" bonded, bonded privileges are given to the whole area and to all business activities, including storing, processing and exhibiting goods, whereas in other areas such privileges are given only independently to each business activity. Being designated as a FAZ does not necessarily mean designation as a comprehensively-bonded area, but a FAZ enjoys scale economies if it is also recognized as a comprehensively-bonded area.

5. The Approved Area in Kobe

Kobe City was included in the initially recognized FAZs which were approved in 1992. Other 5 areas were also approved initially, including Osaka Prefecture (Kansai International Airport area), Osaka City (Osaka Port area), Ehime Prefecture (Matsuyama Port area), Kitakyushu City (Kitakyushu Port area), and Nagasaki Prefecture (Nagasaki International Airport area). Other 6 areas were recognized as FAZs in 1993 and 1994, respectively. Other 3 areas were recognized as FAZs in 1995 and one was added in 1996. Therefore, there exist 22 FAZs in total at the end of 1996. In the case of Kobe, the Kobe port area in the broad sense, i.e. the seaside area from Higashi-nada Ward to Suma Ward was designated as a FAZ. After the Great Hanshin-Awaji Earthquake, not only the 3rd sectors but also private companies were admitted to do import-oriented businesses in FAZs. In addition, the MITI and the Ministry of Home Affairs agreed in 1997 that some areas in the FAZs in Kobe City and Ehime Prefecture would get privileges in the form of local subsidies from the central government.
IV. The Kobe Enterprise Zone: Concept and Its International Implication

1. Background

Kobe city used to have a so-called “big and heavy” industrial complex consisting of steel, ship-building, chemicals and other related industries in the coastal district near Kobe Port. The changing economic environment in Japan, particularly after the sharp appreciation of the yen in the mid-1980s, caused movement away from the coastal industrial district in Kobe. Also, small scale local industry situated mainly in the inner-city district has lost competitiveness, being confronted with emerging competitors from the NIEs/ASEAN region. Therefore, the Kobe economy has been in the process of finding and growing new industrial seeds which have good prospects for the future. Many other cities which, like Kobe, heavily depend on declining industries have been suffering from similar economic stagnation. The Kobe area, however, has had the most serious economic problems since its economy heavily depends on business transactions related to Kobe Port, which has also been losing its competitiveness against such growing Asian ports as Pusan, Kaohsiung, Hong Kong and Singapore.

At 5:46 a.m. on January 17, 1995, the Great Hanshin-Awaji Earthquake (the Southern Hyogo Prefectural Earthquake) occurred and inflicted unprecedented heavy damage on Kobe City and the surrounding area, including Akashi, Amagasaki, Ashiya, Nishinomiya and Takarazuka cities and Awaji Island. The officially announced value of damaged stock amounts to about ¥10 trillion (It is about 5 times bigger than the case of the Northridge Quake in 1994). The lost flow (income) caused by the interruption of business is also quite large; it will be about 1.4 times more than the direct loss at the time of one year later than the occurrence according to our own separate research (cf, Toyoda and Kochi (1997)). The facilities of Kobe Port were also heavily damaged, and has had a serious economic effect, particularly in the Kobe City area.

In Japan, main policy measures for recovery and restoration following big natural disasters are decided by the so-called “top down” system (a system conveyed from the central government to local governments), the case of the Great Hanshin-Awaji Earthquake being the same. There exist at least two big problems in policy making during major crises, including natural disasters, in Japan. First, no single clearly defined agency which has competence and overall responsibility has been organized. Second, no public financial resources have been prepared or funded. These organizational defects have
caused, to some degree, the rather slow recovery and restoration process of both citizens' lives and business activity.

In the early stage after the quake, many people and organizations, including both national and local governments, as well as groups of volunteers from inside and outside the country, quickly undertook devoted and sympathetic relief activities. The biggest problem after that has been how to rebuild and restore the area hit as a "renaissance" district.

The local governments, including those of Hyogo Prefecture and Kobe City, announced restoration plans in the summer of 1995. Urban and housing plans were very important and urgently needed. In addition to these urgent matters, a new concept of economic infrastructure was included in the plans. (See, e.g., Hyogo Prefecture (1995), Kobe City (1995a, 1995b)); This had the aim of not only a return to the pre-quake economic situation but of liberating the area from the difficult stagnant economic situation. Under this background, both Hyogo Prefecture and Kobe City presented their concept of an "Enterprise Zone".

2. Experiments in Other Countries

The concept of an EZ is derived from Prof. Peter Hall's proposal in 1977 to set free ports in the severely stagnant areas of the UK to promote business activity and create employment by exempting them from taxes and remitting commercial legislation, economic regulations and controls for some limited period, specifically for 10 years. In the UK, 11 zones were designated first in 1981/82, and the number of zones expanded to 27 as of 1993. EZs were introduced in the UK as an experiment to develop stagnant area and create employment. Several evaluation reports have appeared, incorporating costs-benefits analyses. It is interesting to look at the recent report (PA Cambridge Economic Consultant (1989)), which concludes that companies located in the EZs have performed relatively better than companies located elsewhere in the local economies and that this is the case whether performance is measured by growth in investment, real output or employment.

In the US, the concept of EZ was first introduced at a state level, i.e., at Illinois, in 1979. At the federal level, the Regan administration adopted EZ first in 1982. EZ was introduced in the US just as in the case of the UK in order to mitigate unemployment in severely depressed regions and also redevelop urban area(s) in the regions. Various tax
exemption and deregulation measures were legislated with time limits of 20 years (See Abe (1986)). Note that, in the US, there are also export-oriented free trade zones (FTZ), which were first adopted in 1974: The number of zones were 9 in 1974 but now more than 550.

3. Characteristics of the Kobe EZ

The present proposal for an EZ in the Kobe region is for the area of the FAZ mentioned above. There are several possibilities for the location but currently only the Port Island (2nd-stage) has been declared as an EZ by the local governments. Not only the Port Island (2nd-Stage) District but also the Rokko Island South District will have no obstacles to satisfy the conditions even for comprehensively-bonded areas. Other areas, e.g., Port Island District, Rokko Island District, Eastern Industrial Block District and some inner-city districts will be possible candidates of EZs although these districts do not meet the conditions for comprehensively-bonded areas.

The EZ in Kobe has the following characteristics:

First, it is a broader concept than the one used in the UK and US. In addition to the narrower concept given to a very depressed area in order to create new jobs and redevelop the urban area, it aims to utilize the FAZ institution. In this sense it is a multi-purpose device. In fact, the plan of the EZ in the Port Island (2nd-stage) District proposed by Kobe City includes three areas which each have related but different purposes; a trade area, a business area and a shopping and entertainment area. It is intended to fully utilize tax incentives and deregulation and also apply the comprehensively-bonded area system. It features the establishment of the Kobe International Multimedia and Entertainment City (KIMEC) plan. Therefore, it is a place for modern industries related to, among others, multimedia information, sales and amusements. Not only manufacturing but also service industries are supposed to play important roles in the EZ.

Second, it is an import-oriented or import promotion zone. In this sense, this is a new idea, indeed, the first of its kind in the world. The existing FTZs in the world aim, more or less, at export expansion as the final goal. The existing EZs in the world aim mainly at employment creation and regional redevelopment rather than at free international trade. The Kobe EZ will be one of the schemes of the FAZ, whose main purpose is, of course, import facilitation. Enterprises in the EZ will do business related to storing and processing goods due to the privileges given in the comprehensively-bonded area, but
their business goals will be restricted to domestic demand only.

Third, it is a device to attract FDI in addition to foreign goods. Privileges should be given not only to domestic but also to foreign enterprises. It has just been announced in April, 1996, that not only the 3rd sector but also permitted private firms can receive various privileges in the FAZ in Kobe. As stated in Section 2, Japan should draw more inward FDI as a leading country in APEC and the Kobe EZ will be a good and visible device for that strategy. Foreign firms with relatively high skills, particularly in such service sectors as information processing, software development, computer graphics, retailing, healthcare businesses and entertainment, will have a good chance to enter Japan's market through the Kobe EZ.

4. Features of the Kobe EZ


At present as of March, 1997, only the Port Island (2nd stage) has been declared as a possible place of an EZ by Kobe City and thereafter I refer to that area as the Kobe EZ. For the purpose of promoting rapid industrial recovery, expiration of the Zone is scheduled, tentatively, five years from establishment of the Kobe EZ.

(a) Five Industrial Sectors Admitted to the Kobe EZ

A special committee for the City of Kobe selected and recommended five suitable industries for the Kobe EZ. They are the following five sectors:

(1) Lifestyle sector (i.e., wide range of apparel, food, housing, leisure industries, all possessing fashionable quality)

(2) Information and telecommunication sector

(3) Internationalization sector

(4) Tourism sector

(5) Distribution sector.

Which particular companies or facilities in these industries are to receive incentives will be determined by future deliberation on the merits of their public benefit and range of influence.

(b) “Core Facilities” to be Promoted Initially in the Kobe EZ

These are the central to this corporate site and will be offered special incentives to
encourage them to establish their facilities there as early as possible, according to the Kobe City announcement. Core facilities involve operations that promote the public good and services, are innovative and will have significant impact on their industries.

At present, such facilities are supposed to be described as follows:

(1) Those that train personnel who will contribute to the development of growing industries

(2) Those that conduct R & D on key technologies for growing industries or promote the transfer of such technologies from abroad

(3) Those that are communications bases themselves or aim to promote the use of such bases

(4) Those that conduct business aimed at promoting information gathering, dissemination, and exchange

(5) Those that offer consolation on business development for companies operating foreign capital or new businesses

(6) Those that supply corporate sites at an inexpensive rate during the start-up period of a growing industry

(7) Those that attract many visitors.

From these characteristics of proposed "core facilities", it seems that the Kobe City is putting importance on the information and telecommunication sector as well as its related amusement facilities. I would like to propose that a big shopping mall which treat (tariff) duty free goods should be included in "core facilities" in addition to the above mentioned sectors.

(c) Incentives Proposed by Kobe City and Hyogo Prefecture

The above mentioned ordinances set by both the City of Kobe and the Prefecture of Hyogo declares some incentives for the selected industrial sectors. These declarations should be highly evaluated as a first step for local governments to become more independent from the central government. Although the details are still under deliberation, the announced incentives include the followings:

(1) Property tax: 50 % reduction for 3 years

(2) Urban planning tax: 50 % reduction for 3 years

(3) Real estate acquisition tax: 50 reduction (maximum 200 million yen)

(4) Office rent subsidy system
(5) Corporate location incentive loan system
(6) Feasibility study subsidy system
(7) New business creation program: Maximum subsidy for R & D is 70 million yen and the one for new products or services is 7 million yen
(8) New business venture capital: Capital procurement for those businesses that contribute to earthquake reconstruction; 200 million yen per company at maximum.

In addition to the above listed incentives for the five industries, the following also applies to “core facilities”:
(1) Business premises tax: 50 % reduction for 3 years for new facilities and future extensions on such facilities
(2) Construction fee subsidy
(3) Rent subsidy to assist foreign companies that become tenants in the International Business Support Center
(4) Interest subsidy toward construction expenditure.

V. Concluding Remarks

In this paper we have evaluated the proposed concept of an EZ in the Kobe region positively.

First, we have reviewed the role and the outline of the FAZs in Japan and confirmed their importance for import facilitation and the nation’s welfare.

Second, we have reviewed some of the world’s enterprise zones and confirmed their importance for the reactivation of economically stagnant local regions.

Third, we have examined the proposed EZ in Kobe, and found the following:
1) It is a mixture of an FAZ and a usual concept of an EZ;
2) It is a multi-purpose device to restore and activate the Kobe economy, to make an experiment of deregulation with tax incentives to find their macroeconomic impacts and to promote more imports and inward FDI both in goods and services.

Reactivation of the Kobe economy is of vital importance for the disaster area. The policy of experimental deregulation with tax incentives has the potential for application to other areas to liberate Japan from the present depressed atmosphere and find some new industrial seeds. Promoting imports and inward FDI is beneficial not only to Japan
but also to other countries.

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