



It Is Time to Do Away with Special Economic Zones

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Special Economic Zones¹ began acquiring prominence in the 1960s at a time when protectionism was the norm, global trade was barnacled with barriers and in most countries, industrialization was often hamstrung by bureaucratic red tape. Because abolishing the many impediments in one go was deemed impossible, policymakers attempted to sidestep the many political and institutional obstacles by carving out enclaves subject to a different system of rules. It was rightly assumed that by pruning the regulatory rent generating thicket and easing the weight of taxes and tariffs in these locations, foreign investors would be attracted and they in turn would stimulate domestic business activity. This worked for the early movers but in the decades since, economies have opened up and the developmental landscape has changed enormously however, countries developed and developing continue to bet on SEZs to improve their industrial prospects. The question is why. The answer presented below is that they are a handy and politically expedient instrument of regional and industrial policies and too often, countries continue to establish zones although they have ceased to deliver the outcomes they once may have done in a few East Asian countries.

Zones birthing

At the dawn of the SEZ story, policy ambitions were limited. Governments were refurbishing a tool, which had been gathering dust, and hoping that it would provide a needed economic nudge. If the experiment worked, it could open the door to the creation of additional zones. And if it garnered sufficient political support, the same policies could be mainstreamed and applied more widely. In those early days, there was little talk of spillovers from SEZs and of the zones giving rise to virtuous spirals that enhanced the fortunes of the local and or regional economies.

The area adjacent to Shannon airport in Ireland's Clare County hosted the first "modern" SEZ in 1959.² Among the developing economies, India led the way by establishing the first export processing

1 The term SEZ covers zones of many stripes: free trade zones; export processing zones; industrial estates; and others.
2 Freeports—an early manifestation of a SEZ—began cropping up centuries ago with Genoa and Livorno among the first—both acquiring fame as trading cities. <https://www.theguardian.com/cities/2016/apr/19/story-of-cities-25-shannon-ireland-china-economic-boom>

zone at Kandla on the western coast of the sub-continent. In the late 1960s and early 1970s, some countries in East Asia concluded that Import Substituting Industrialization (ISI) was a dead end and began casting around for other means of accelerating industrialization (Irwin 2020). SEZs, FTZs, EZs, and bonded warehouses (benefitting shipping and warehousing activities) appeared to be low-risk options and were adopted by Korea, Taiwan, Singapore, China, and several Southeast Asian economies such as Malaysia and Thailand.³ Early movers found that the tax and tariff incentives extended to firms that set up shop in SEZs, the elastic supply of labor, the provision of land, subsidized services, and infrastructure, attracted FDI, transferred technology, boosted industrialization and employment, and promoted exports.⁴ MNCs flocked to these zones in East Asia⁵ and created dynamic industrial clusters producing largely or exclusively for the foreign market.

The 1980s and the 1990s were the heyday of globalization with trade growing at high single digit rates thanks to the trade liberalization resulting from eight rounds of tariff negotiations that culminated in the creation of the WTO in 1995.⁶ Consequently, these pioneering zones and parks flourished and in time became the industrial cores of dynamic cities—and eventually of mega urban regions. The Kaohsiung FTZ in Taiwan was an early success story as was Korea's SEZ in Masan (Warr 1984). The Bayan Lepas Free Industrial Zone in Penang established on 1,000 acres of land near the airport in 1972, revitalized the city and over the years, an expansion of the area encompassed by the zone gave rise to a large electronics cluster populated by subsidiaries of 350 MNCs and over 3,000 local SMEs that supply parts and services.⁷ A SEZ and the Laem Chabang port launched Thailand's Eastern Economic Corridor in the early 1980s. It has become an industrial hub rivalling Bangkok with a cluster of light truck and commercial vehicle assemblers supported by an ecosystem comprised of thousands of parts suppliers.⁸ Several other zones/parks such as Hsinchu Science Park in Taiwan dating back to the early 1970s, did remarkably well by leveraging the advantages conferred by its location adjacent to a leading University (Tsing Hua) and an expanding urban agglomeration (Zeng 2021).

Arguably the most famous SEZ and the one directly responsible for the persistent popularity of zones is Shenzhen, which was a relative latecomer.⁹ In 1979, the City of Shenzhen had a population of 300,000, spread over 2,020 sq. km. After reform was initiated in China, Shenzhen was one of four SEZs that were trialed starting in 1980. The Shenzhen SEZ occupied about a third of Bao'an County, an area of approximately 328 sq.km with about 100,000 people (Du 2020, p.14). Shenzhen took more than ten years and many billions of dollars of investment in infrastructure¹⁰ to acquire real traction but

3 However, import controls remained in force for the rest of the economy and only began to be eased from the 1990s onwards.

4 These actions were bolstered by capital controls and the undervaluation of the exchange rate. Bergin, Choi and Pyun (2023) find that these controls alongside other actions led to reserve accumulation, promoted manufacturing and growth.

5 The migration of Japanese firms to Southeast Asia was triggered by the Plaza Accord in 1985 that revalued the yen and compelled manufacturers to move labor intensive activities to countries where wage costs were lower.

6 https://www.wto.org/english/thewto_e/history_e/history_e.htm

7 <https://www.semi.org/en/sea-newsletter-penang-the-silicon-valley-of-the-east>

8 https://www.nesdc.go.th/ewt_dl_link.php?nid=6473

9 Aggarwal (2012) argues that even though China was a relative latecomer to the SEZ game, it exploited the potential of zones more effectively than either Korea or Taiwan because the early Chinese zones especially Shenzhen, gave rise to massive industrial clusters and have served as the engines of China's growth.

10 Chen (1993) estimates that investment in Shenzhen's infrastructure amounted to \$8 billion.

in the four decades since it has morphed into a smart mega city (part of the Bay Area urban region) and an economic powerhouse with a population of over 12.8 million in 2022 (Hu 2020; Du 2020; UN Habitat 2019).¹¹

Zones proliferating

Thousands of SEZs/FTZs have been established since the mid 1980s in the hope of imitating the industrial successes of the Shenzhens and Penangs. The purpose is to nurture “Silicon Valley transplants” such as Hsinchu Park, to initiate an enduring urban-industrial growth spiral and in many cases, to seed new growth poles or to spur the development of lagging regions and reduce the concentration of the urban population in a few major cities. There is an enduring and widely propagated myth that if a SEZ could transform a mere fishing village like Shenzhen then planting a zone could perform such alchemy virtually anywhere. But as Du (2020, p.15) explains in detail, Shenzhen is (was) a “unique place” with certain characteristics that enabled it to fulfil the role it was assigned. “[This] included a preexisting terrain of farming fields and aquaculture along the coast, a history of significant urban and rural settlements and numerous unrecognized communities, among them hundreds of thousands of indigenous villagers.” Shenzhen’s proximity to Hong Kong also proved to be a valuable asset because once the opportunities arose capital, industry and skills flowed from Hong Kong to Shenzhen, some of it from Taiwan and other East Asian countries.¹² However, hope springs eternal. As of 2022, UNCTAD counted 7,000 in 145 countries with hundreds more in the pipeline.¹³ For example, Indonesia, Malaysia, Thailand, and Vietnam have created well over 2,500 zones of various kinds since the 1990s. By 2021, India had approved the creation of 425 SEZs.¹⁴

The number of zones multiplied rapidly between 1995 and 2002. A second acceleration occurred after 2014. The zones are spreading not just in low and lower middle-income countries wanting to move higher up the industrial ladder such as Cambodia, Myanmar, and Pakistan, but also in upper middle-income countries including Malaysia—an early mover—that established the Johore Economic Region in 2006, the Northern Economic Corridor Region in 2007 and the East Coast Economic Region in 2009. China added free trade zones (FTZs) where goods could be manufactured and traded without the intervention of customs in 2013 and by 2021, there were 21 in total contributing 17.3 percent of China’s trade and absorbing 18.5 percent of FDI.¹⁵ SEZs have continued to sprout in Korea since the

11 Shenzhen averaged a growth rate of 20 percent p.a. for four decades. https://paulromer.net/deep_structure_growth/; <https://news.cgtn.com/news/2020-10-16/The-real-secret-of-Shenzhen-s-40-year-economic-miracle-UCUhXDIiMiY/index.html>; By the early 2020s, the growth rate was declining with Shenzhen having to cope with the Covid pandemic and problems besetting some of its leading firms such as Huawei, ZTE and Evergrande. <https://indianexpress.com/article/world/miracle-city-shenzhen-fears-china-economic-future-7967959/>

12 Later, capital from the Chinese mainland began roundtripping through Hong Kong to exploit the incentives given to foreign investors.

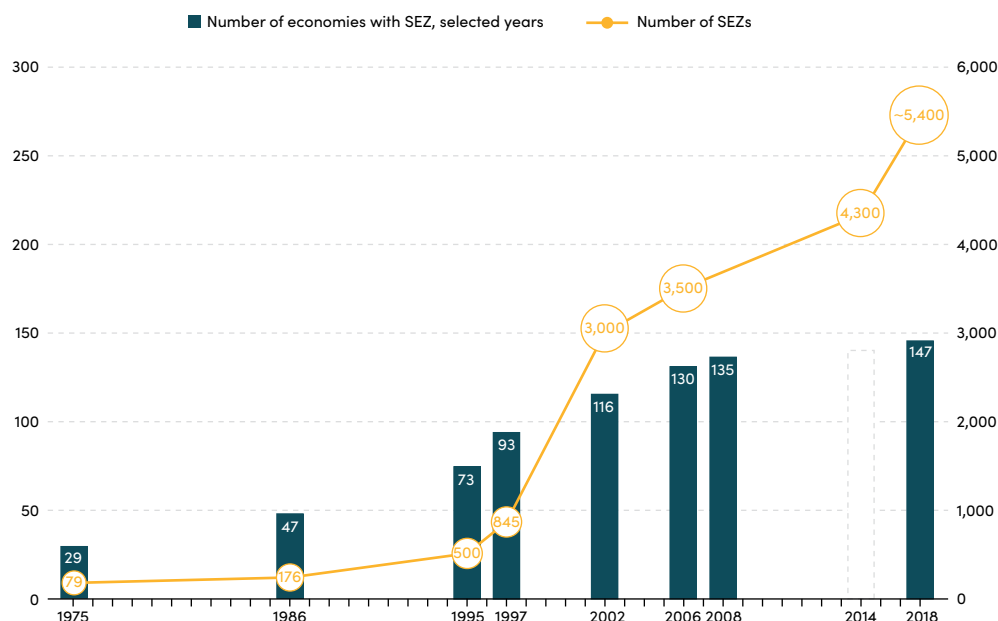
13 UNCTAD launched a global alliance of SEZs to share knowledge. <https://unctad.org/news/new-global-alliance-special-economic-zones-boost-development>

14 <https://www.india-briefing.com/news/guide-indias-special-economic-zones-9162.html/>; Indian capital has roundtripped through Mauritius into SEZs in India. Financial Times (October 30th, 2018) <https://www.ft.com/content/b2a35d1e-c597-11e8-86b4-bfd556565bb2>

15 <https://www.tradecommissioner.gc.ca/china-chine/ftz-zle.aspx?lang=eng>

turn of the century such as the Incheon FEZ (Free Economic Zone) in 2003 and the Chungbuk FEZ in 2013. Saudi Arabia has launched a massively ambitious Red Sea Project, which will be a luxury resort cum high tech development zone. Among the European countries, Poland has been actively building zones since 1995 with 14 operating as of 2018,¹⁶ and to assist its recovery following the debt crisis, Greece took the plunge in 2012.¹⁷ There are FTZs in Japan e.g., in Okinawa, Naha, and Nigata.¹⁸ And thanks to the twice amended Foreign Trade Zones Act first introduced in 1934 (New York hosted the first in 1937; ADB 2015), there are literally dozens of FTZs in the United States with a presence in virtually every state and most notably in California, Florida, and Texas.¹⁹ Along with rising developmental ambitions, countries—especially higher middle- and high-income ones—have raised their sights. Consequently, zones have tended to become spatially more expansive, multisectoral, with complex structures, and in the MICs (middle-income countries), there is a greater focus on attracting high tech industry.²⁰

Figure 1. The increase in the number of SEZs 1975–2018



Source: UNCTAD (2019) World Investment Report.

Note: The trend is indicative only. Historical estimates are based on ILO (2014) for 1975, 1986, 1995, 1997, 2002, and 2006; FIAS (2008) for 2008; *The Economist* (2015) for 2014; and UNCTAD for 2018. Scope and definitions of the various estimates across years may differ.

16 The first SEZ in Poland’s Mielec region, which was launched soon after the passage of the SEZ bill by the legislature in 1994, served as a test bed.

17 <https://www.reuters.com/article/us-greece-economy-zones/greece-plans-special-economic-zones-to-boost-growth-idUSBRE87R09820120828>

18 <https://www.healyconsultants.com/japan-company-registration/free-zones/>

19 https://en.wikipedia.org/wiki/Foreign_trade_zones_of_the_United_States

20 There is no evidence to suggest that the zones have helped to raise the share of manufacturing or stem its decline in upper middle- and high-income countries or contributed to their growth. The share of manufacturing in GDP has dipped steadily in Malaysia since 1999 (from 31 percent to 23 percent), has stagnated at around 17 percent in Poland and in the United States it has fallen from 16 percent in 1997 to 11 percent in 2021. <https://data.worldbank.org/indicator/NV.IND.MANF.ZS?locations=MY-PL-US>

Zone addiction

What accounts for their continuing appeal? When tariff and non-tariff barriers and taxes were high and regulation could be a burdensome obstacle, SEZs offered a way of circumventing these and creating an extraterritorial space much like a “charter city”²¹ with its own fiscal rules, laws, and administration. However, at least since the 1990s, countries have been racing to liberalize, goaded by a host of widely publicized indices that rank performance using indicators to assess the business environment, innovativeness, openness to trade and capital, logistics capability, governance, transparency, the restrictiveness of entry barriers, strength of legal institutions, and security of property rights—just to name the most prominent. Because these rankings influence business decisions and FDI, they, WTO rules, and the much-derided Washington Consensus have substantially lowered impediments to trade and tax rates and countries have weeded out many of the more egregious regulatory checks on businesses. Generous treatment of foreign investment is on offer everywhere because countries are forced to compete. Figure 2 shows the steep drop in worldwide mean tariff rates from 15 percent in 1990 to 5.2 percent in 2017. The average for high income countries was 3.9 percent, 6.8 percent for low- and middle-income countries and 11 percent for low-income countries.

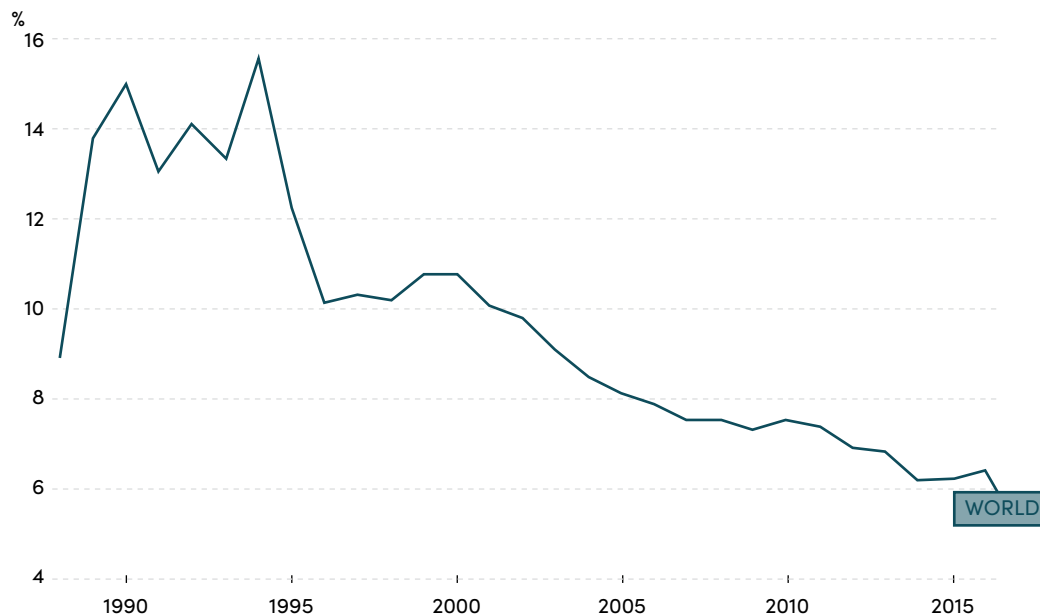
The creation of SEZs might have served a useful purpose in times when trade and development were hindered by protectionism, high taxes, a variety of entry barriers that increased the cost of doing business and discouraged FDI. But globalization led to a great reset, and digitalization has further lowered transaction costs. The justification for SEZs in most middle- and high-income countries has largely evaporated and where kinks remain, they need to be eliminated countrywide—and not papered over by SEZs.

Increasingly, SEZs are serving as instruments of the government’s regional and industrial policies. Countries are using SEZs to fulfil political promises and bolster the economies of lagging regions; and they are attempting to spur industrialization and move up the value chain by attracting FDI. But the cost can be high in terms of tax revenues sacrificed, investment in infrastructure in places where it generates low returns, and a distortion of the spatial distribution of economic activity (exacerbated by coordination failures in an evolving developmental environment) that on balance are productivity and growth diminishing (Duranton and Venables 2018). Whether tax exemptions used to attract FDI are effective—and needed—has been debated for decades and although every SEZ offers some kind of tax relief, the research to date does not provide convincing validation. Foreign investors are more likely to be lured by infrastructure quality, political stability and security of assets, the supply of labor and labor laws, access to land with secure title, social and environmental rules, the legal system, the

21 <https://chartercitiesinstitute.org/intro/>; <https://citymonitor.ai/government/what-is-a-charter-city>

size of the domestic market (as in China and India), and other costs of doing business. Tax holidays are icing on the cake.²²

Figure 2. Simple mean tariff rate for all products 1988–2017 (global average in percent)



Source: WDI (2023) <https://data.worldbank.org/indicator/TM.TAX.MRCH.SM.AR.ZS>

Rigorous benefit cost analyses of SEZs, which take full account of the outlay on infrastructure, the cost of incentives in terms of lost revenue and tax expenditures and the opportunity cost of investment in SEZs, are scarce (ADB 2015).²³ Only a small minority have measured up to expectations, attracted the desired volume and mix of foreign investment, led to increasing exports²⁴ and in time, become important industrial hubs with substantial nationwide or even regional linkages (Gibbon, Bair and Ponte 2008). Some have turned in a middling performance and the majority have fallen short of expectations or are outright failures embroiled in scams of one sort or the other (Economist 2015; Jeong 2016; Zeng 2021).²⁵ India reaped little benefit from the export zones developed between 1965 and 2000 (Aggarwal 2016). Their influence on the economic growth of users has appeared to

22 The pros and cons of tax incentives are explored by Munongo et al (2017). Doubts are expressed by Blomstrom (2002) and echoed by Morriset (2003) who notes that although early adopters such as Ireland and Singapore made good use of tax incentives when rates worldwide were high, their utility has diminished. MNCs are more concerned with the simplicity and stability of the tax system than with the generosity of the rebates. Anderson, Kett and von Uexkull (2017) observe that “Tax incentive regimes in developing countries often suffer from weak design, lack of transparency, and cumbersome administration, which can diminish the attractiveness of incentives and raise their indirect costs in terms of economic distortions and potential for corruption. Tax incentives tend to attract efficiency-seeking FDI motivated by lowering production costs than other types of investment. Tax incentives impose significant costs on the countries using them, including fiscal losses, rent-seeking, tax planning and evasion, administrative costs, economic distortions, and retaliation.”

23 The mixed findings of the few studies of Asian countries are summarized in ADB (2015).

24 The export levels of economies with SEZs were comparable to those without. ADB (2015) *ibid*.

25 Zeng (2021) observes that “SEZs as a unilateral economic development policy are not easy to get right, and even successful SEZs usually take a decade or more to start showing results.”

weaken over time. Increasing the number of SEZs makes no difference and is counterproductive,²⁶ and SEZs have not led to a convergence of regional incomes (Aggarwal 2022). Moreover, few have been located with an eye to their viability under changing climatic conditions.

“In other latecomer countries, there are many more cases of zones that, once established by law, [have] remained un- or underdeveloped for decades, and today’s stock of SEZs includes many underutilized zones.²⁷ Even where zones have successfully generated investment, jobs and exports, the benefits to the broader economy—a key part of their rationale—have often been hard to detect; many zones operate as [largely self-contained] enclaves, [lacking] links to local suppliers and [with] few spillovers.” (UNCTAD 2019)

SEZs and other zones cannot be relied upon by late starters to jumpstart and sustain industrialization or even to deconcentrate urbanization.²⁸ For example, the impact of Pakistan’s industrial estates and SEZs on its industrial growth and diversification is imperceptible (Khan 2019). Furthermore, it is uncertain whether the nine zones currently under implementation as part of the China Pakistan Economic Corridor (CPEC)²⁹ will do any better as applying lessons learned by China and other East Asian economies and attracting FDI in the Pakistan context will be an uphill task.³⁰

SEZ takeaways

At best, after an initial spurt, the performance of SEZs tends to taper and is on par with that of the rest of the economy.³¹ Enriching incentives makes little difference, while increasing fiscal costs, including through tax expenditures (World Bank 2017; Moberg 2018). The few zones or industrial estates that have delivered outsize results were strategically located adjacent to existing or potential transport hubs in urbanizing regions that were a source of labor, entrepreneurship, services, and easy connections with international markets. Synergy between SEZs and growing “production” cities,³² resulted in the flourishing, export-oriented industrial outcomes observed in Kaohsiung,

26 Zone inflation reshuffles investment rather than increasing it and making it more productive.

27 Rodriguez-Pose et al (2022) observe that the number of SEZs in African countries is exploding and while they can provide African nations with additional developmental tools, they carry “enormous opportunity costs for countries that are often afflicted by severe economic and institutional deficits, their ability to attract investors is hampered by restrictive practices and consequently the volume of investment and the number of jobs created is limited. Overall, SEZ development has failed to significantly alter the economic fortunes of African countries at the bottom of the development pyramid.”

28 The old wine from East Asia is past its sell by date.

29 The genesis of China’s initiative to establish SEZs abroad was the encouragement given by the authorities to firms and banks (e.g., the China Development Bank) to “going global” in 1998. This was followed by a policy decision in 2006 to create 50 overseas SEZs. The reasoning behind this decision is examined by Brautigam and Tang (2014).

30 The tortuous approval process has hampered the building of the necessary infrastructure and slowed the processing of applications by investors. Institutional weaknesses including those of the legal system, are also discouraging for investors. Pakistan shares these problems with many other developing countries. Nigar and Qayyum (2021); Hussain and Rao (2020).

31 Research by Hyun and Ravi (2018) indicates that India’s SEZ Act introduced in 2005 may have improved the prospects of some of the country’s zones by increasing private sector participation. They find that production in the larger zones is increasing as is productivity, the zones are inducing informal enterprises to become part of the formal sector and night light data suggests that SEZs are giving rise to spillovers. Whether this is continuing is hard to verify.

32 Production cities according to Jedwab, Ianchovichina and Haslop (2022) are those with a high share of urban tradable products and services. In consumption cities—many in developing economies—non tradables produced by formal and informal entities dominate the urban output.

Masan, Penang, the Greater Bay Area³³ and in the Yangtze Basin that were seeded by zones created in the 1980s. At first, domestic value added by assembly and processing was minimal however, the SEZs enlarged foreign exchange earnings and over time helped diversify the industrial base, build a labor force for modern industry and institute workplace rules. Science parks that have nurtured technologically more advanced activities are even more tightly linked with cities as these promote spillovers, are a source of venture capital, generate the talent and research that feeds the growth of industry and provide the “creative class” with a desirable urban environment (Liang et al 2019; Florida 2012; 2013).

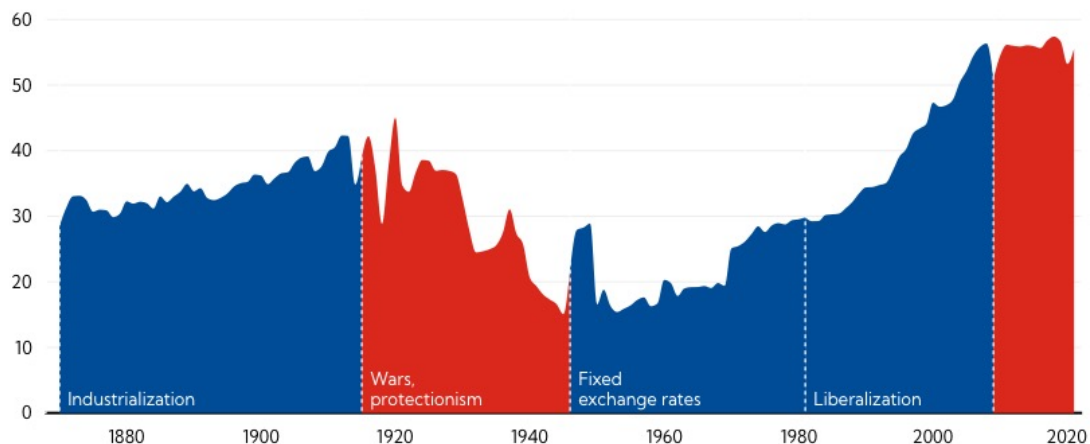
There are lengthy lists of recommendations on how to improve the functioning of SEZs in World Bank, ADB and AfDB reports, and in the literature spawned by the topic.³⁴ However, going forward, at least four lessons that can be dredged from experience both recent and dating back to the 1970s and 1980s, are most pertinent: First, the catalytic function of SEZs as industrializing and urbanizing agents, is less apparent as we come closer to the present. What worked in East Asia and under conditions prevailing three decades and more ago before the explosion in the number of zones had occurred,³⁵ infrequently delivers results under current circumstances especially now that the contribution of manufacturing industry to growth is diminishing and light, labor-intensive manufacturing has lost its pole position in the race to industrialize. Many of the impediments that justified the creation of SEZs, have been removed and countries need to eliminate the ones that remain countrywide thereby leveling the playing field and ensuring the optimal (spatial) allocation of resources. At this point in time, a scattering of SEZs is a second or third best policy option. The few that appear to succeed will be in the most developed parts of the country and could be diverting investment from other regions instead of delivering a net increment. Furthermore, the globalizing surge and with it the lowering of trade barriers worldwide, which commenced in the 1970s and triggered the wave of outsourcing, crested and is now beginning to ebb and “slowbalization” brought about by geo-economic fragmentation, (among other reasons) along with selective reshoring of industry to developed countries, is ongoing (Figure 3). Light manufacturing and assembly activities that were footloose have largely transferred out of advanced economies. A second wave of industrial outsourcing to Africa and South Asia from China and Southeast Asia may be in the offing, but thus far there is a trickle only from China and Malaysia. How much will change because of the shock inflicted by the Covid pandemic and geopolitical tensions, is difficult to foresee. If the next unbundling largely consists of digital services, these do not require a SEZ to thrive.

33 Eleven percent of China’s GDP was sourced from the Greater Bay Area in 2021. “The Greater Bay Area comprises 11 major cities of the Pearl River Delta in southeastern China, including Hong Kong Special Administrative Region (SAR), Macao SAR, as well as nine key cities in Guangdong Province of mainland China, including Guangzhou and Shenzhen”. <https://www.spglobal.com/marketintelligence/en/mi/research-analysis/chinas-greater-bay-area-becomes-key-mega-region-in-global-economy-June22.html>; <https://www.weforum.org/agenda/2018/08/megacity-2020-the-pearl-river-delta-s-as-tonishing-growth/>

34 SEZs continue to be touted in spite of reservations. See AfDB (2014); Alexianu et al (2019).

35 A remark by Hector Valezzi (2012) is pertinent. “If you build [SEZs] all over the country, the zones will not be special. And this is what happened in Mexico... An SEZ must have special attributes in terms of location and how it is promoted. It should also be special because it is a temporary measure.”

Figure 3. Trends in globalization: sum of exports and imports as percent of GDP



Sources: PIIE, Jorda-Schularick-Taylor Macrohistory Database, Penn World Data (10.0), World Bank, and IMF staff calculations.
 Note: Sample's composition changes over time.
 Note: Sample's composition changes over time.

Second, it is hard to think of instances where the creation of one or several zones enabled a country to “leapfrog” to a higher technological plane than was warranted by its comparative advantages (Farole 2011). Moreover, in recent decades, SEZs that are responsible for the formation of industrial clusters for example in Bangladesh and Vietnam, have not served as escalators facilitating technological upgrading and diversification into more complex activities. Countries like Bangladesh are seemingly caught in a textile industry trap. Bangladesh’s economic complexity ranking declined between 2000 and 2020 from 89 to 111. Vietnam did better going from 79th place to 61st however, its industrial focus remains on the assembly and processing of electronic equipment, garments and footwear—in that order.³⁶

Third, regional development policies with and without SEZs have a poor track record. Few have succeeded in improving the growth prospects of lagging regions and lessening regional disparities (e.g., OECD Cohesion policies; Rothenberg et al 2017³⁷). Isolated SEZs, with inadequate infrastructure of indifferent quality, distant from transport hubs and poorly served by urban labor markets

³⁶ OEC (2023). <https://oec.world/en/rankings/eci/hs6/hs96>; <https://oec.world/en/profile/country/vnm>

³⁷ The poor outcomes of Indonesia’s regional development program (KAPET) are analyzed by Rothenberg et al (2017); Regionally targeted policies are examined by Grover, Lall and Maloney (2022). “Place-based policies—spatially targeted interventions aiming to boost economic development in particular geographical areas—are being increasingly adopted around the world, but their results too often fall short of expectations. As widening spatial inequalities leave billions of people ever farther behind, policy makers in many developing countries seek to respond with spatially targeted interventions. Typically involving expensive new infrastructure, such policies are justified by appealing to a need for socially inclusive growth and economic opportunity in lagging areas.” The persistence of regional disparities in Europe and the inability of market forces or of policies to narrow gaps are discussed by I. Iammarino, A. Rodriguez -Pose and M. Storper (2019). Among the problems they identify that retard convergence policy interventions notwithstanding, are the poor quality of governance and institutions. “In the case of Europe, many regions and cities which are either lagging behind or declining have weaker ‘good’ institutions—such as those that promote entrepreneurship and confidence in the future—and often have more robust ‘bad’ institutions—such as those that promote rent-seeking, corruption, or lack of confidence—than their more developed counterparts. This has led to a proliferation of white elephants that may have responded to short-term electoral or private gains, but which, in the medium-term, have contributed little to addressing the lack of opportunity in lagging and declining areas.”

might limp along for a while with the help of subsidies, but the investment will have a low payoff. Zones created to serve political objectives (and not with reference to commercial or economic considerations) or to revive backward regions are especially handicapped and unlikely to germinate viable industrial hubs (Farole 2020). Dedicated transport corridors cannot rescue bad projects (Aggarwal 2020).³⁸ They drain resources and divert them from other more productive uses.

Fourth, worldwide trends indicate that economic activity—and increasingly populations—are concentrating in a few large urban regions. This is apparent in high income countries and in emerging economies. As climate change gathers momentum, more people and businesses are likely to gravitate towards urban centers enjoying longer term locational advantages e.g., are less exposed to severe weather, to rising temperatures and the sea level, and can access an adequate supply of potable water.³⁹ The attractions of the mega-urban region are enhanced by agglomeration/urbanization and scale economies that confer productivity gains. A large urban region can also accommodate a diverse range of activities that contribute to innovation, resilience, and viability both economic and fiscal (Florida 2017).⁴⁰ Furthermore, the servitization of manufacturing as it progresses means that the contiguity of manufacturing and services in the urban space can confer advantages to both. And because many services of the kind that support manufacturing tend to cluster in large cities, the most productive hubs are those—or will be the ones—that include a dynamically evolving mix of manufacturing and linked services. The chances of a zone or an industrial park acquiring traction are greater in a major urban region with deep pools of labor, infrastructure and public services and international connectivity.

If the future of the most dynamic growing economic activities is tied to the fortunes of mega-urban regions, then the focus of incentive policies should be on cities rather than on SEZs. In fact, SEZs are redundant when located in mega regions and often ineffective if they are established in remote cities and lagging regions. Once incentive policies target the mega region, a nationwide development strategy that takes cognizance of climate change would score over one that puts its faith in SEZs paired with regional policies. China's "open cities" policy introduced in 1984 was along these lines.⁴¹ It offered the same incentives as were available in SEZs, but the urban corporate taxes were higher.

To sum up, SEZs are an anachronism and have no place in the modern policy toolkit. That they continue to multiply reflects a failure to learn from experience, as well as a reluctance to come to terms with the need to focus policy actions on enhancing the productivity, livability, and resilience

38 Aggarwal (2020). "[Although], corridors are increasingly seen as a tool to foster regional trade and economic development, initial evidence shows that the gains are relatively modest and non-uniform... there is a lack of coherent understanding of the corridor as a policy tool, the critical success factors, governance, and issues and challenges related with them."

39 This was a minor consideration in the past. It is no longer. The infrastructures needed to safeguard SEZs in exposed locations would greatly add to the cost. Having to factor in climate change now affects how countries can deploy this instrument for development purposes.

40 Florida (2017) observes that "Innovation is geographically uneven. The world's 40 richest mega-regions—expansive conurbations such as the Boston–New York–Washington DC corridor, Greater London, or the passage that runs from Shanghai to Beijing—account for more than 85% of the world's patents, and 83% of the most-cited scientists. And yet, only 18% of the world's population lives in them."

41 <https://www.fdicchina.com/blog/special-economic-zones-china/>; <https://www.worldbank.org/content/dam/Worldbank/Event/Africa/Investing%20in%20Africa%20Forum/2015/investing-in-africa-forum-chinas-special-economic-zone.pdf>

of key mega urban regions and to acknowledge that spatial development going forward needs to be steered with reference to changing climatic conditions. Countries developing and developed need to give due attention to geography of urbanization in a warming world and take steps to ensure populations are concentrated in areas with the most favorable economic prospects over the longer run and that can be rendered resilient at the least cost. Climate change and other factors will call for considerable economic restructuring. Demand for investment will rise. Even more reason for countries to maximize the return from each unit of capital by avoiding wasteful expenditures on SEZs and redundant transport corridors and investing in the most advantaged urban engines of growth.⁴² The major urban centers will lead the way.⁴³

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42 How to make cities smarter and more productive is the topic of an immense literature. E.g., McKinsey (2015).

43 This was how it was in the past and is the message of recent publications. NITI Aayog and ADB (2022); Hausmann et al (2020) examine how a city can become an autonomous growth engine, which rises above the national rate; that larger cities in developing countries have an edge in productivity is shown by Collier et al (2018) using LandScan data; and Bettencourt et al (2007) observe that "The increasing concentration of people in cities presents both opportunities and challenges toward future scenarios of sustainable development...Cities make possible economies of scale in infrastructure and facilitate the optimized delivery of social services, such as education, health care, and efficient governance... The most striking feature of the data is perhaps the many urban indicators that scale superlinearly ($\beta > 1$). These indicators reflect unique social characteristics ...and are the quantitative expression that knowledge spillovers drive growth that such spillovers in turn drive urban agglomeration and that larger cities are associated with higher levels of productivity. Wages, income, growth domestic product, bank deposits, as well as rates of invention, measured by new patents and employment in creative sectors all scale superlinearly with city size, over different years, and nations with exponents that, although differing in detail, are statistically consistent."

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