



EMBARGO

The contents of this Report must not be quoted or summarized in the print, broadcast or electronic media before

12 June 2019, 17:00 GMT.

(1 p.m. New York; 7 p.m. Geneva;
10.30 p.m. Delhi; 2 a.m. on 13 June, Tokyo)

WORLD INVESTMENT REPORT 2019

SPECIAL ECONOMIC ZONES

KEY MESSAGES AND OVERVIEW



UNITED NATIONS

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD



WORLD INVESTMENT REPORT 2019

SPECIAL ECONOMIC ZONES

KEY MESSAGES AND OVERVIEW



UNITED NATIONS
Geneva, 2019

© 2019, United Nations

This work is available through open access, by complying with the Creative Commons licence created for intergovernmental organizations, at <http://creativecommons.org/licenses/by/3.0/igo/>.

The designations employed and the presentation of material on any map in this work do not imply the expression of any opinion whatsoever on the part of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries.

Photocopies and reproductions of excerpts are allowed with proper credits.

This publication has been edited externally.

United Nations publication issued by the United Nations Conference on Trade and Development.

UNCTAD/WIR/2019 (Overview)

PREFACE

The *World Investment Report* supports policymakers by monitoring global and regional foreign direct investment trends and documenting national and international investment policy developments. The policy chapter of this year's report takes stock of efforts being made towards the reform of international investment agreements and surveys new measures.

Inclusive sustainable development depends on a global policy environment that is conducive to cross-border investment. Last year, global flows of foreign direct investment fell by 13 per cent, to \$1.3 trillion. This represents the lowest level since the global financial crisis and underlines the lack of growth in international investment this decade. The significant acceleration required to meet the investment needs associated with the Sustainable Development Goals is not yet apparent. We need to raise ambition on climate action, address debt vulnerabilities and reduce trade tensions to foster environments that are conducive to scaling up long-term and sustainable investments.

Among the most important instruments for attracting investment are Special Economic Zones. The number of zones around the world has grown rapidly this decade to more than 5,000, with many more planned. This *World Investment Report* provides an overview of the global SEZ landscape and offers advice on how to respond to fundamental challenges for zones posed by the sustainable development imperative, the new industrial revolution and changing patterns of international production.

I commend this year's *World Investment Report* for both industrial and investment policymakers, and as an important tool for the international development community.



António Guterres
Secretary-General of the United Nations

FOREWORD

For some time now, the global policy climate for trade and investment has not been as benign as it was in the heyday of export-led growth and development. Yet the need to attract investment and promote exports to support industrialization, economic diversification and structural transformation is as great as ever for developing countries, especially the least developed countries.

The many new industrial policies that have been adopted in recent years – in both developing and developed countries – almost all rely to a significant degree on attracting investment. At the same time, we are observing a declining trend in cross-border productive investment.

The market for internationally mobile investment in industrial capacity is thus becoming increasingly difficult and competitive. The demand for investment is as strong as ever, the supply is dwindling and the marketplace is less friendly than before.

It is in this context that we are seeing explosive growth in the use of special economic zones (SEZs) as key policy instruments for the attraction of investment for industrial development. More than 1,000 have been developed worldwide in the last five years, and by UNCTAD's count at least 500 more are in the pipeline for the coming years.

There are many examples of SEZs that have played a key role in structural transformation, in promoting greater participation in global value chains and in catalyzing industrial upgrading. But for every success story there are multiple zones that did not attract the anticipated influx of investors, with some having become costly failures.

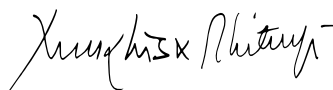
In countries with an SEZ portfolio or with ambitious SEZ development programmes, policymakers and practitioners – in ministries responsible for industry, trade and investment; in SEZ authorities; and in export and investment promotion agencies, to mention a few – are looking to turn around underperforming zones and to ensure that new ones meet expectations.

In doing so, they not only have to contend with the challenges associated with a more difficult trade and investment climate. They face other challenges as well. One is the new industrial revolution, which could erode the importance of low labour costs, the traditional competitive edge of most SEZs. SEZs will need to anticipate trends in their targeted industries and adapt.

But even more important is that, today, sustainable development – as embodied in the United Nations Sustainable Development Goals – must guide SEZ strategy and operations. In a break from the past, adopting the highest social, environmental and governance standards for zones is becoming a competitive advantage.

The *World Investment Report 2019* surveys the universe of SEZs today, provides an overview of SEZ laws and regulations, and assesses the sustainable development impact of SEZs. The report offers recommendations through three lenses: lessons learned from the past, a forward-looking perspective and a pioneering idea in the form of “SDG model zones”.

I hope that the report will inspire and reinvigorate efforts around the world to make investment work for development through SEZs. UNCTAD stands ready to support stakeholders in this endeavour.



Mukhisa Kituyi
Secretary-General of UNCTAD

ACKNOWLEDGEMENTS

The *World Investment Report 2019* was prepared by a team led by James X. Zhan. The team members included Richard Bolwijn, Bruno Casella, Arslan Chaudhary, Hamed El Kady, Kumi Endo, Thomas van Giffen, Kálmán Kalotay, Joachim Karl, Isya Kresnadi, Oktawian Kuc, Jing Li, Anthony Miller, Kyounggho Moon, Abraham Negash, Shin Ohinata, Diana Rosert, Astrit Sulstarova, Claudia Trentini, Elisabeth Tuerk, Joerg Weber and Kee Hwee Wee.

Research support and inputs were provided by Jorun Baumgartner, Faicel Belaid, Magdalena Bulit Goni, Juan Carlos Castillo, Tiffany Grabski, Yulia Levashova, Luisa Sande Lemos, Sergey Ripinsky and Linli Yu. Interns Zahra Ejehi, Robert Kuhn, Alina Nazarova and Mxolisi Artwell Ngulube also contributed.

Comments and contributions were provided by Stephania Bonilla, Joseph Clements, Chantal Dupasquier, Ariel Ivanier, Mathabo Le Roux, Massimo Meloni, Jason Munyan, Yongfu Ouyang, Ian Richards, Christoph Spennemann and Paul Wessendorp.

Statistical assistance was provided by Bradley Boicourt, Mohamed Chiraz Baly, Smita Lakhe and Lizanne Martinez.

The manuscript was edited with the assistance of Caroline Lambert and copy-edited by Lise Lingo. Pablo Cortizo designed the charts, maps and infographics; he and Laurence Duchemin typeset the report. Production of the report was supported by Elisabeth Anodeau-Mareschal, Nathalie Eulaerts, Rosalina Goyena, Sivanla Sikounnavong and Katia Vieu.

The report benefited from extensive advice from François Bost and Rajneesh Narula on chapter IV. At various stages of preparation, including during the expert meetings organized to discuss drafts, the team received comments and inputs from these experts: Aradhna Aggarwal, Xiangming Chen, Teresa Cheng, Manjiao Chi, Riccardo Crescenzi, Stefan Csordas, Thomas Farole, Masataka Fujita, Yeseul Hyun, N. Jansen Calamita, Markus Krajewski, Alexey Kuznetsov, Olga Kuznetsova, Guangwen Meng, Maria Camila Moreno, Shree Ravi, Emily Sims, Ilan Strauss, Juan Torrents and Giovanni Valensisi.

The report benefited also from collaboration with colleagues from the United Nations Regional Commissions for its sections on regional trends in chapter II. Inputs and comments were provided by Wafa Aidi, Joseph Baricako, Mohamed Chemingui, Martin Kohout, Laura Páez Heredia, José Palacín, Maria Cecilia Plottier, Marc Proksch, Giovanni Stumpo and Heather Taylor.

Also acknowledged are comments received from other UNCTAD divisions as part of the internal peer review process, as well as comments from the Office of the Secretary-General. The United Nations Cartographic Section provided advice for the regional maps.

Numerous officials of central banks, national government agencies, international organizations and non-governmental organizations also contributed to the report.

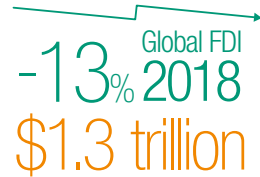
TABLE OF CONTENTS

PREFACE	iii
FOREWORD	iv
ACKNOWLEDGEMENTS	vi
KEY MESSAGES	ix
OVERVIEW	1
GLOBAL TRENDS AND PROSPECTS	1
REGIONAL TRENDS	9
INVESTMENT POLICY TRENDS	15
SPECIAL ECONOMIC ZONES	22

KEY MESSAGES

INVESTMENT TRENDS AND PROSPECTS

Global foreign direct investment (FDI) flows continued their slide in 2018, falling by 13 per cent to \$1.3 trillion. The decline – the third consecutive year’s fall in FDI – was mainly due to large-scale repatriations of accumulated foreign earnings by United States multinational enterprises (MNEs) in the first two quarters of 2018, following tax reforms introduced by that country at the end of 2017.



FDI flows to developed economies reached the lowest point since 2004, declining by 27 per cent. Inflows to Europe halved to less than \$200 billion, due to negative inflows in a few large host countries as a result of funds repatriations and to a sizeable drop in the United Kingdom. Inflows in the United States also declined, by 9 per cent to \$252 billion.

Flows to developing countries remained stable, rising by 2 per cent. As a result of the increase and the anomalous fall in FDI in developed countries, the share of developing countries in global FDI increased to 54 per cent, a record.

- *FDI flows to Africa rose by 11 per cent to \$46 billion, despite declines in many of the larger recipient countries.* The increase was supported by continued resource-seeking inflows, some diversified investments and a recovery in South Africa after several years of low-level inflows.
- *Flows to developing Asia, the largest recipient region, were up 4 per cent.* In a sign of continued dynamism, greenfield project announcements in the region doubled in value, recovering from their 2017 pause.
- *FDI in Latin America and the Caribbean was 6 per cent lower, failing to maintain momentum after the 2017 increase halted a long slide.*

FDI downward trend



FDI in the region is still 27 per cent lower than during the peak of the commodities boom.

- *FDI flows to structurally weak and vulnerable economies continued to account for less than 3 per cent of the global total.* Flows to the least developed countries recovered from their 2017 fall, back to \$24 billion, the average for the decade.

FDI flows to economies in transition continued their downward trend in 2018, declining by 28 per cent to \$34 billion, driven by a 49 per cent drop in flows to the Russian Federation.

The tax-driven fall in FDI was cushioned by increased transaction activity in the second half of 2018. The value of cross-border merger and acquisitions (M&As) rose by 18 per cent, fueled by United States MNEs using liquidity in their foreign affiliates that was no longer encumbered by tax liabilities.

In 2019, FDI is expected to see a rebound in developed economies as the effect of the tax reforms winds down. Greenfield project announcements – indicating forward spending plans – also point at an increase, as they were up 41 per cent in 2018 from their low 2017 levels. Despite this, *projections for global FDI show only a modest recovery of 10 per cent to about \$1.5 trillion*, below the average over the past 10 years. The underlying FDI trend remains weak. Trade tensions also pose a downward risk for 2019 and beyond.

The underlying FDI trend has shown anemic growth since 2008. FDI net of one-off factors such as tax reforms, megadeals and volatile financial flows has averaged only 1 per cent growth per year for a decade, compared with 8 per cent in 2000–2007, and more than 20 per cent before 2000. Explanations include declining rates of return on FDI, increasingly asset-light forms of investment and a less favourable investment policy climate.

The long-term slide of greenfield investment in manufacturing halted in 2018, with the value of announced projects up 35 per cent from the low value in 2017. Among developing countries – where manufacturing investment is key for industrial development – the growth was mostly concentrated in Asia and pushed up by high-value projects in natural resource processing industries.

Greenfield investment
in manufacturing
up 35%



The number of State-owned MNEs (SO-MNEs) stabilized, and their acquisitions abroad slowed down. There are close to 1,500 SO-MNEs, similar to 2017. Their presence in the top 100 global MNEs increased by one to 16. The value of their M&A activity shrank to 4 per cent of total M&As in 2018, following a gradual decline from more than 10 per cent on average in 2008–2013.

Top 100 MNEs
account for more than
1/3 of business-funded
R&D worldwide

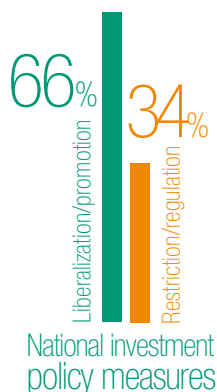
Much of the continued expansion of international production is driven by intangibles. Non-equity modes of international production are growing faster than FDI, visible in the relative growth rates of royalties, licensing fees and services trade. The top 100 MNE ranking for 2018 confirms that industrial MNEs are sliding down the list, with some dropping out.

MNEs in the global top 100 account for more than one third of business-funded R&D worldwide. Technology, pharmaceutical and automotive MNEs are the biggest spenders. The R&D intensity (relative to sales) of the developing-country top 100 is significantly lower. International greenfield investment in R&D activities is sizeable and growing.

A significant part of investment between developing countries (South–South FDI) is ultimately owned by developed-country MNEs. New data on the global network of direct and indirect bilateral FDI relationships shows the important role of regional investment hubs in intraregional FDI and in South–South FDI. Indirect investment also has implications for the coverage of international investment agreements.

INVESTMENT POLICY DEVELOPMENTS

New national investment policy measures show a more critical stance towards foreign investment. In 2018, some 55 economies introduced at least 112 measures affecting foreign investment. More than one third of these measures introduced new restrictions or regulations – the highest number for two decades. They mainly reflected national security concerns about foreign ownership of critical infrastructure, core technologies and other sensitive business assets. Furthermore, at



least 22 large M&A deals were withdrawn or blocked for regulatory or political reasons – twice as many as in 2017.

Screening mechanisms for foreign investment are gaining importance. Since 2011, at least 11 countries have introduced new screening frameworks and at least 41 amendments have been made to existing regimes. Changes included adding sectors or activities subject to screening, lowering the triggering thresholds or broadening the definition of foreign investment. Other new regulations have expanded disclosure obligations of foreign investors, extended statutory timelines of screening procedures or introduced new civil, criminal or administrative penalties for not respecting notification obligations.

Nevertheless, attracting investment remains a priority. The majority of new investment policy measures still moved in the direction of liberalization, promotion and facilitation. Numerous countries removed or lowered entry restrictions for foreign investors in a variety of industries. The trend towards simplifying or streamlining administrative procedures for foreign investment continued. Also, several countries provided new fiscal incentives for investment in specific industries or regions.

International investment policymaking is in a dynamic phase, with far-reaching implications. In 2018, countries signed 40 international investment agreements (IIAs). For at least 24 existing treaties, terminations entered into effect. The impact on the global IIA regime of novel features in new agreements, including some megaregional treaties with key investor countries, will be significant. Many countries are also developing new model treaties and guiding principles to shape future treaty making.

IIA reform is progressing, but much remains to be done. Almost all new treaties contain numerous elements in line with UNCTAD's Reform Package for the International Investment Regime. UNCTAD's policy tools have also spurred initial action to modernize old-generation treaties. Increasingly, countries interpret, amend, replace or terminate outdated treaties. However, the stock of old-generation treaties is 10 times larger than the number of modern, reform-oriented treaties. Investors continue to resort to old-generation treaties; in 2018, they brought at least 71 new investor-State dispute settlement (ISDS) cases.



Total IIAs in force

2658

IIA reform actions are also creating new challenges. New treaties aim to improve balance and flexibility, but they also make the IIA regime less homogenous. Different approaches to ISDS reform, ranging from traditional ad hoc tribunals to a standing court or to no ISDS, add to broader systemic complexity. Moreover, reform efforts are occurring in parallel and often in isolation. Effectively harnessing international investment relations for the pursuit of sustainable development requires holistic and synchronized reform through an inclusive and transparent process. UNCTAD can play an important facilitating role in this regard.

71 new
ISDS cases

Sustainable capital market trends

Capital market policies and instruments designed to promote the integration of sustainability into business and investment practices are transitioning from niche to mainstream. A growing number of investors are integrating ESG factors into their investment decision making to enhance performance and mitigate risk. The positive track record of sustainability-themed products is reinforcing the views of asset managers and securities regulators that such factors are material to long-term investment performance. As these sustainable investment trends take root and expand, they can have a stronger influence on the operational policies and practices of MNEs.

SPECIAL ECONOMIC ZONES

Special economic zones (SEZs) are widely used in most developing and many developed economies. Within these geographically delimited areas governments facilitate industrial activity through fiscal and regulatory incentives and infrastructure support. There are nearly 5,400 zones across 147 economies today, up from about 4,000 five years ago, and more than 500 new SEZs are in the pipeline. The SEZ boom is part of a new wave of industrial policies and a response to increasing competition for internationally mobile investment.

SEZs come in many types. Basic free zones focused on facilitating trade logistics are most common in developed countries. Developing economies tend to employ integrated



5 400
zones
across
147
economies

zones aimed at industrial development, which can be multi-industry, specialized or focused on developing innovation capabilities. The degree and type of specialization is closely linked to countries' level of industrialization, following an *SEZ development ladder*.

Many new types of SEZs and innovative zone development programmes are emerging. Some focus on new industries, such as high-tech, financial services, or tourism – moving beyond the trade- and labour-intensive manufacturing activities of traditional SEZs. Others focus on environmental performance, science commercialization, regional development or urban regeneration.

International cooperation on zone development is increasingly common. Many zones in developing countries are being built through bilateral partnerships or as part of development cooperation programmes. Regional development zones and cross-border zones spanning two or three countries are becoming a feature of regional economic cooperation.

SEZs can make important contributions to growth and development. They can help attract investment, create jobs and boost exports – both directly and indirectly where they succeed in building linkages with the broader economy. Zones can also support global value chain (GVC) participation, industrial upgrading and diversification. However, none of these benefits are automatic.

In fact, *the performance of many zones remains below expectations.* SEZs are neither a precondition nor a guarantee for higher FDI inflows or GVC participation. Where they lift economic growth, the stimulus tends to be temporary: after the build-up period, most zones grow at the same rate as the national economy. And too many zones operate as enclaves with limited impact beyond their confines.

Only a few countries regularly assess the performance and economic impact of zones. Doing so is critical, because the turnaround of unsuccessful SEZs requires timely diagnosis, especially when there has been a significant level of public investment in zone development. UNCTAD's *SEZ Sustainable*

Development Profit and Loss Statement (P&L) can guide policymakers in the design of a comprehensive monitoring and evaluation system.

SEZ Sustainable
Development
Profit and Loss
Statement 

The decades-long experience with SEZs provides important lessons for modern zone development:

- *Strategic design of the SEZ policy framework and development programme is crucial.* Zone policies should not be formulated in isolation from their broader policy context, including investment, trade and tax policies. The types of zones and their specialization should build on existing competitive advantages and capabilities. And long-term zone development plans should be guided by the SEZ development ladder.
- *Zone development programmes should take a frugal approach.* The Sustainable Development P&L emphasizes the need for financial and fiscal sustainability of zones, as their broader economic growth impact can be uncertain and take time to materialize. High upfront costs due to overspecification, subsidies for zone occupants and transfers to zone regimes of already-operating firms pose the greatest risks to fiscal viability.
- *The success of individual SEZs depends on getting the basics right.* Most failures can be traced back to problems such as poor site locations that require heavy capital expenditures or that are far away from infrastructure hubs or cities with sufficient pools of labour; unreliable power supplies; poor zone design with inadequate facilities or maintenance; or overly cumbersome administrative procedures.
- *Active support to promote clusters and linkages is key to maximizing development impact.* Firms operating in zones have greater scope to collaborate, pool resources and share facilities – more so in specialized zones, but multi-activity zones can extract some of the benefits of co-location. Pro-active identification of opportunities, matching efforts and training programmes, with firms within and outside the zone, significantly boosts the impact.
- *A solid regulatory framework, strong institutions and good governance are critical success factors.* The legal infrastructure of SEZs should ensure consistent, transparent and predictable implementation of SEZ policies. The responsibilities of SEZ governing bodies should be clearly defined. Zones benefit from having public and private sector representatives on their boards.

Looking ahead, SEZs face *new challenges*:

- The sustainable development agenda increasingly drives MNEs' strategic decisions and operations, which should be reflected in the value proposition

that SEZs market to investors. *Modern SEZs can make a positive contribution to the ESG performance of countries' industrial bases.* Controls, enforcement and services (e.g. inspectors, health services, waste management and renewable energy installations) can be provided more easily and cheaply in the confined areas of SEZs.

SEZs are traditionally big employers of women, with about 60 per cent female employees on average. Some modern zones are implementing gender equality regulations, such as anti-discrimination rules, and support services, such as child care and schooling facilities, setting new standards for SDG performance.

- The new industrial revolution and the digital economy are changing manufacturing industries – the main clients of SEZs. *SEZs will need to adapt their value propositions to include access to skilled resources, high levels of data connectivity and relevant technology service providers.* SEZs may also have new opportunities to target digital firms.
- The current challenging global policy environment for trade and investment, with rising protectionism, shifting trade preferences and a prevalence of regional economic cooperation, is causing changes in *patterns of international production and GVCs*. These changes can significantly affect the competitiveness of SEZs, which function as central nodes in GVCs. International cooperation on zone development is likely to become increasingly important.

Finally, the 2030 Agenda to achieve the Sustainable Development Goals (SDGs) provides an opportunity for the development of an entirely new type of SEZ: the SDG model zone. Such zones would aim to attract investment in SDG-relevant activities, adopt the highest levels of ESG standards and compliance, and promote inclusive growth through linkages and spillovers.

The recommendations in this report aim to provide guidance for policymakers in their efforts to revitalize and upgrade existing zones, and to build new ones that avoid the pitfalls of the past and are prepared for the challenges ahead. The key objective should be to make SEZs work for the SDGs: *from privileged enclaves to sources of widespread benefits.*



New type of SEZ:
SDG model zone

OVERVIEW

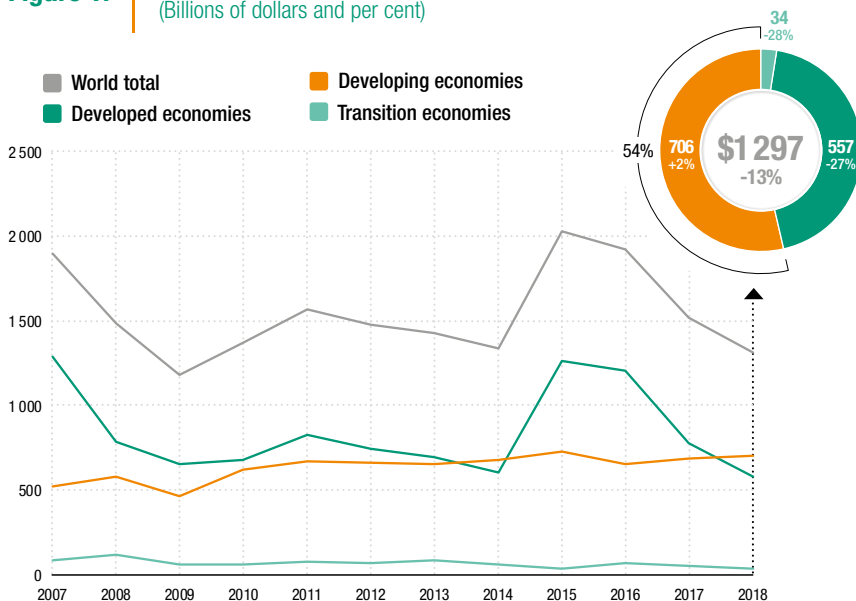
Global trends and prospects

Global FDI fell for the third year in a row

Global foreign direct investment (FDI) flows continued their slide in 2018, falling by 13 per cent to \$1.3 trillion (figure 1). The decline – the third consecutive year's fall in FDI – was mainly due to large-scale repatriations of accumulated foreign earnings by United States multinational enterprises (MNEs) in the first two quarters of 2018, following tax reforms introduced in that country at the end of 2017.

The tax-driven fall in the first half of 2018 (which ended 40 per cent lower than the same period in 2017) was cushioned in the second half by increased

Figure 1. FDI inflows, global and by economic group, 2007–2018
(Billions of dollars and per cent)



Source: UNCTAD.

transaction activity. The value of cross-border merger and acquisitions (M&As) rose by 18 per cent, fueled by United States MNEs using liquidity in foreign affiliates that was no longer encumbered by tax liabilities.

FDI to developed countries dropped to the lowest level in 15 years

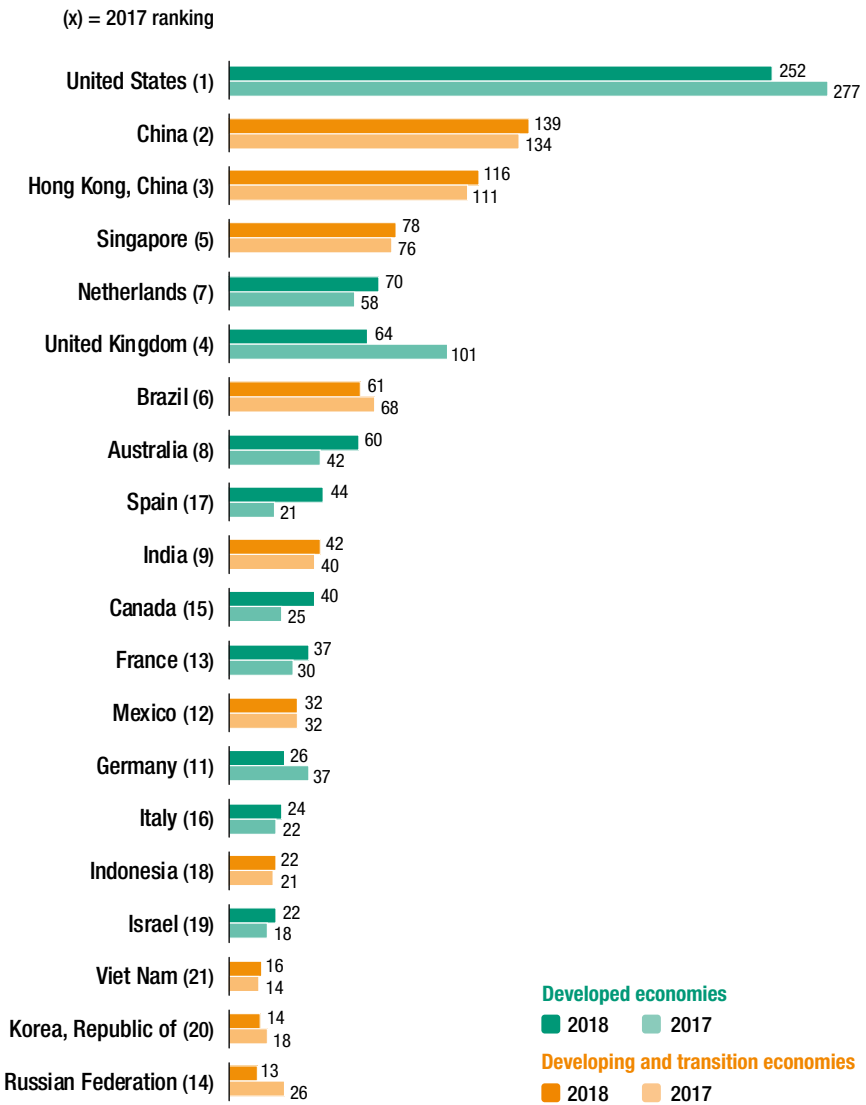
FDI flows to developed economies reached their lowest point since 2004, declining by 27 per cent. Inflows to Europe halved to less than \$200 billion; a few important host countries of United States MNEs registered negative inflows. (The repatriation of funds by United States MNEs translated into negative inflows in host countries.) FDI flows to Ireland and Switzerland fell to -\$66 billion and -\$87 billion, respectively. FDI flows to the United Kingdom also declined, by 36 per cent to \$64 billion, as new equity investments halved. FDI into the United States declined as well, by 9 per cent to \$252 billion – the average of the last 10 years. That decline was mainly due to a fall by one third in cross-border M&A sales. Australia's FDI inflows reached \$60 billion – a record level – as foreign affiliates reinvested a record \$25 billion of their profits in the country.

FDI flows to developing economies remained stable, rising by 2 per cent to \$706 billion. As a result of the increase and the anomalous fall in developed countries, the share of developing economies in global FDI increased to 54 per cent, a record. Their presence among the top 20 host economies remained unchanged (figure 2). The United States remained the largest recipient of FDI, followed by China, Hong Kong (China) and Singapore.

The large-scale repatriations of funds by United States MNEs translated into negative FDI outflows, causing the United States to disappear from the list of the top 20 outward-investing economies in 2018 (figure 3). Overall, outward FDI from developed countries as a group fell by 40 per cent to \$558 billion. As a result, their share in global outward FDI dropped to 55 per cent – the lowest ever recorded. Nevertheless, outward investment by European MNEs rose 11 per cent to \$418 billion. France became the third largest investor home country, with FDI outflows of more than \$100 billion in 2018.

Outward investment by MNEs from developing economies declined by 10 per cent to \$417 billion. Outflows from developing Asia fell by 3 per cent to \$401 billion; investment by Chinese MNEs declined for the second consecutive year. Outflows from Latin America and the Caribbean contracted sharply.

Figure 2. FDI inflows, top 20 host economies, 2017 and 2018
(Billions of dollars)



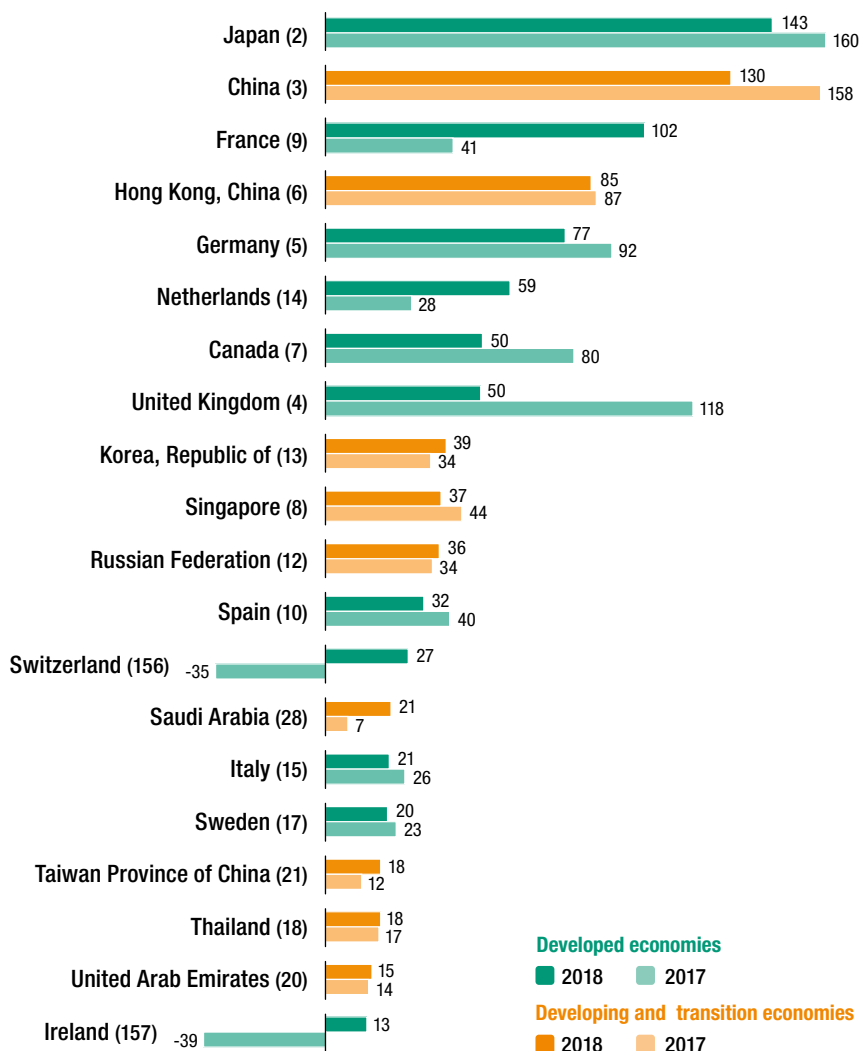
Source: UNCTAD.

Figure 3.

FDI outflows, top 20 home economies, 2017 and 2018

(Billions of dollars)

(x) = 2017 ranking



Source: UNCTAD.

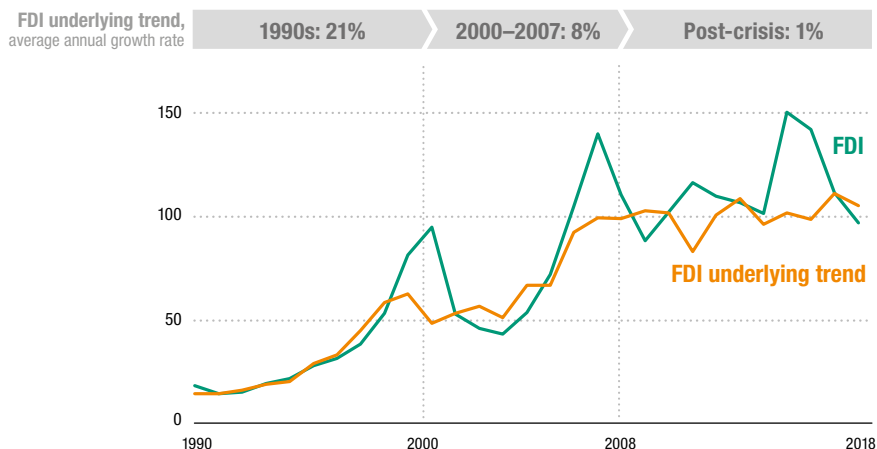
Prospects: a rebound is likely, but the underlying trend remains weak

In 2019, FDI is expected to see a rebound in developed economies as the effect of the United States tax reform winds down. Greenfield project announcements – indicating forward spending plans – also point at an increase, as they were up 41 per cent in 2018 from their low 2017 levels. Despite these positive indicators, projections for global FDI show only a modest recovery of 10 per cent to about \$1.5 trillion, below the average over the past 10 years. Growth potential is limited because the underlying FDI trend remains weak. Trade tensions also pose a downward risk for 2019 and beyond.

The underlying FDI trend has shown anemic growth since 2008. Net of fluctuations caused by one-off factors such as tax reforms, megadeals and volatile financial flows, it has averaged only 1 per cent growth per year this decade, compared with 8 per cent in 2000–2007, and more than 20 per cent before 2000 (figure 4).

Key drivers for the long-term slowdown in FDI include declining rates of return on FDI, increasingly asset-light forms of investment and a less favourable investment policy climate.

Figure 4. FDI inflows and the underlying trend, 1990–2018
(Indexed, 2010 = 100)



Greenfield recovered, but unevenly

The value of announced greenfield investment projects recovered from its slump in 2017, with a 41 per cent increase to \$961 billion. The bulk of the increase came from a doubling of announced projects in Asia.

The long-term slide of greenfield investment in manufacturing – critical for industrial development in developing countries – halted in 2018. In developing economies, the value of announced projects in manufacturing rose by 68 per cent to \$271 billion. Most of the increase took place in Asia, but announced projects also increased markedly in Africa (up 60 per cent); they slumped in Latin America and the Caribbean.

Much of the increase in manufacturing was due to large-scale projects, mostly in natural resource-related processing industries. The number of projects in developing countries rose by a more modest 12 per cent. The growth in the number of projects in typical early-industrialization industries – the type often attracted by SEZs – remained lacklustre.

State-owned MNEs have slowed their international expansion

The number of State-owned (SO) MNEs has stabilized. There are close to 1,500 SO-MNEs, similar to the number in 2017. European SO-MNEs account for a little more than one third of all SO-MNEs, and another 45 per cent are from developing Asian economies, including 18 per cent from China. The presence of SO-MNEs in the top 100 global MNEs increased from 15 to 16. The list includes five SO-MNEs from China and 11 from developed countries.

M&A activity by SO-MNEs has slowed down markedly. SO-MNEs accounted for about 4 per cent of the value of global M&As in 2018, following a gradual decline from more than 10 per cent on average in 2008–2013. The industries most targeted by SO-MNEs are utilities, extractive industries and financial services.

International expansion is asset-light

Much of the continued expansion of international production is driven by intangibles and by non-equity modes of overseas operations, such as licensing and contract manufacturing. The trend is visible in the divergence of key international production indicators – on a scale from tangible to

intangible – with a substantially flat trend for FDI and trade in goods and much faster growth for both trade in services and international payments for intangibles (royalties and licensing fees).

The 2018 ranking of the top 100 MNEs confirms this picture. The growth of foreign sales of the top 100 MNEs outpaces that of foreign assets and foreign employees, suggesting that MNEs can reach overseas markets with a lighter operational footprint. Also, the typically more asset-heavy industrial MNEs in the top 100 are sliding down the ranking, with some dropping out.

MNEs are big R&D spenders

In 2018, MNEs in UNCTAD's top 100 invested more than \$350 billion in R&D, representing over one third of all business-funded R&D. Technology, pharmaceutical and automotive MNEs are the biggest spenders. The R&D intensity (relative to sales) of the developing-country top 100 MNEs is significantly lower.

International greenfield investment in R&D activities is sizeable and growing. During the last five years, MNEs announced 5,300 R&D projects outside their home markets, representing more than 6 per cent of all announced greenfield investment projects, and up from 4,000 in the preceding five years. Developing and transition economies capture 45 per cent of these projects. The majority of R&D-related FDI projects is in relatively lower value added design, development and testing activities, rather than basic research.

South–South FDI is smaller than it looks

WIR19 presents new, innovative data on the ultimate ownership of FDI and on the global network of direct and indirect FDI relationships. The new data reveal that a significant part of FDI between developing countries (South–South FDI) is ultimately owned by developed-country MNEs. The share of South–South investment in total investment to developing economies drops from 47 per cent (when measured on the basis of standard FDI data) to 28 per cent when measured on the basis of ultimate ownership. Regional investment hubs play an important role as conduits in indirect investment flows, and they drive much of intraregional FDI and South–South FDI.

The new data also provide a different perspective on the coverage of IIAs. The ultimate ownership view highlights the multilateralizing effect of indirect FDI.

For some treaties and economic groupings, such as the African Continental Free Trade Area (AfCTA) and the Association of Southeast Asian Nations (ASEAN), where regional hubs have a significant role, the share of direct investment covered by the agreements is higher than the share of investment by ultimate owner.

Regional trends

FDI in Africa on the rise

FDI flows to Africa defied the global downward trend in 2018. They rose to \$46 billion, an 11 per cent increase after successive declines in 2016 and 2017. Rising prices of and demand for some commodities led to sustained resource-seeking investment. A few economies, such as Kenya, Morocco and Tunisia, saw an encouraging increase in diversified investment. FDI in South Africa made a significant recovery after several years of low-level inflows. In contrast, investment in some of the other large recipients, including Nigeria, Egypt and Ethiopia, declined in 2018.

FDI inflows to *North Africa* increased by 7 per cent to \$14 billion. Egypt remained the largest FDI recipient in Africa in 2018, although inflows decreased by 8 per cent to \$6.8 billion. Stable economic growth in Morocco drew investment in several sectors, including automotive and finance; FDI to the country increased to \$3.6 billion. FDI to West Africa fell 15 per cent to \$9.6 billion, the lowest level since 2006, owing to the substantial drop in Nigeria for the second consecutive year. FDI flows to East Africa were largely unchanged at \$9 billion, despite Ethiopia recording an 18 per cent decline to \$3.3 billion. Inflows to Kenya increased by 27 per cent to \$1.6 billion, including some investments in sizeable infrastructure projects. Business facilitation measures and investment-ready SEZs contributed to the trend. FDI flows to Central Africa were stagnant at \$8.8 billion. The Congo recorded inflows of \$4.3, mostly in oil exploration and production. Continued investment in minerals, especially cobalt, underpinned flows to the Democratic Republic of Congo, up 11 per cent to \$1.5 billion. Inflows to *Southern Africa* turned around sharply (\$-0.9 billion to \$4.2 billion), mainly due to the recovery in South Africa, where investment increased from \$2 billion to \$5.3 billion, including substantial investments in automotive and renewable energy. Mozambique also received higher inflows, with an 18 per cent increase pushing FDI to \$2.7 billion. However, this was largely due to intracompany transfers from companies already established in the country, mainly for oil and gas exploration.

The expected acceleration of economic growth in Africa, progress towards the implementation of the AfCFTA and the possibility of some large greenfield investment projects announced in 2018 materializing could drive higher FDI flows to the continent in 2019.

FDI flows to developing Asia increased marginally

FDI inflows to developing Asia rose by 4 per cent to \$512 billion in 2018. Growth occurred mainly in China, Hong Kong (China), Singapore, Indonesia and other ASEAN countries, as well as in India and Turkey. Asia continued to be the world's largest FDI recipient region, absorbing 39 per cent of global inflows in 2018, up from 33 per cent in 2017.

Flows to East Asia rose by 4 per cent to \$280 billion in 2018 but remained significantly below their 2015 peak of \$318 billion. Inflows to China increased by 4 per cent to an all-time high of \$139 billion. Flows to *South-East Asia* were up 3 per cent to a record level of \$149 billion. Robust investment from other Asian economies, including investment diversion and relocations of manufacturing activity from China, supported FDI growth in the region. Strong intra-ASEAN investments also contributed to the trend, although Singapore played a significant role in this as a regional investment hub.

FDI inflows to *South Asia* increased by 4 per cent to \$54 billion, with a 6 per cent rise in investment in India to \$42 billion, driven by an increase in M&As in services, including retail, e-commerce and telecommunication. *West Asia* saw a 3 per cent rise in investment to \$29 billion, halting an almost continuous 10-year downward trend. The largest increases were recorded in Turkey and Saudi Arabia.

Outflows from Asia declined by 3 per cent to \$401 billion, representing 40 per cent of global outward FDI. This was mainly due to reduced investments from China for the second consecutive year, caused by policies discouraging capital outflows, as well as by increased screening of inward investments in Europe and the United States. In contrast, outward investment from the Republic of Korea, Saudi Arabia, the United Arab Emirates and Thailand increased.

The prospects for FDI flows to the region are cautiously optimistic, due to a favourable economic outlook and ongoing efforts to improve the investment climate in several major economies. Announced greenfield investment projects doubled in value in 2018 across Asia, suggesting continued growth potential for FDI. Global trade tensions could negatively affect investor sentiment but could also lead to further investment diversion.

FDI in Latin America and the Caribbean declined

FDI flows to Latin America and the Caribbean decreased by 6 per cent in 2018 to \$147 billion, as the recovery that started in 2017 stalled and external factors weighed down growth prospects. Outward investment by Latin American MNEs plunged in 2018 to a record low of \$6.5 billion, due to negative outflows from Brazil and lower investments from Chile.

In *South America*, FDI declined by an estimated 6 per cent due to lower flows to Brazil and Colombia. In Brazil, flows fell by 9 per cent to \$61 billion, as a result of a challenging economic situation and a sharp decline in M&A deals from record levels in 2017. In Colombia, FDI inflows fell by 20 per cent to \$11 billion. Flows to Argentina were resilient at \$12 billion, buoyed by flows into shale gas production. Flows into Chile rose marginally – by 4 per cent to \$7.2 billion – sustained by higher copper prices and record levels of M&As in the mining, health services and electricity industries. In Peru, flows decreased by 9 per cent to \$6.2 billion, despite solid economic growth and heavy investment in the mining industry. In *Central America* FDI inflows were largely stable at \$43 billion. In Mexico increasing reinvested earnings by existing foreign affiliates led to unchanged inflows at \$32 billion. Flows to Panama were up 21 per cent to \$5.5 billion, boosted by record M&A deals and mining projects. In Costa Rica, a sudden pause in investment in tourism was responsible for most of the decline in FDI inflows to \$2.1 billion. In the *Caribbean*, excluding offshore financial centres, flows declined by 32 per cent. The contraction was due to lower FDI (\$2.5 billion) in the Dominican Republic, the largest recipient in the subregion, despite its strong economic growth in 2018. Flows to Haiti and Jamaica also fell, to \$105 million and \$775 million, respectively.

Investment flows to and from the region could plateau as commodity prices and economic conditions in major economies stabilize. Natural resources, infrastructure and consumer goods (especially goods and services related to information and communication technology) should continue to attract foreign investors. Yet the region's lower growth projections compared with last year's forecasts and its vulnerability to external factors, such as monetary policy in the United States and trade tensions among key trading partners, put a downward risk on prospective FDI inflows.

FDI flows to transition economies continue to slide

FDI flows to the transition economies of South-East Europe and the Commonwealth of Independent States (CIS) declined in 2018 for the second consecutive year. Investment to the region dropped by 28 per cent to \$34 billion. The contraction was driven by the halving of flows to the Russian Federation, by far the biggest economy and largest recipient in the group, from \$26 billion to \$13 billion, in part due to international political factors and domestic policies aimed at reducing investment round-tripping. Some of the other larger recipients in the region – Azerbaijan, Kazakhstan and Ukraine – also saw declining inflows. In contrast, flows were buoyant in *South-East Europe*, especially in Serbia and North Macedonia. Serbia became the second largest FDI recipient among transition economies as inflows grew by 44 per cent to \$4.1 billion, driven by a surge in new equity capital.

Outflows from transition economies remained unchanged at \$38 billion, making the region a net FDI capital exporter in 2018. The Russian Federation accounted for 95 per cent, with outflows of \$36 billion – almost three times more than inflows. The rise was driven mainly by reinvested earnings in and loans to established affiliates. Equity investment in new greenfield ventures and foreign acquisitions declined by almost half, reflecting caution about overseas expansion.

FDI inflows in the transition economies are expected to stabilize in 2019. Growth prospects for inflows into South-East Europe, where greenfield project announcements doubled in 2018, are more positive.

FDI to developed economies falls sharply

FDI flows to developed economies fell by 27 per cent to \$557 billion, marking the third successive year of decline. Whereas the decline in 2017 was primarily due to subdued M&A activity, the main factor in 2018 was the repatriation of accumulated earnings by United States MNEs following tax reforms. Outflows from developed economies declined by 40 per cent to \$558 billion. Outflows from European economies increased, but outflows from the United States fell to a net divestment of -\$64 billion (representing a decline of \$364 billion from 2017).

Inflows to Europe halved to \$172 billion, the lowest level since 1997. FDI in important host economies for United States MNEs, such as Ireland and Switzerland, was negative (with repatriations of funds to the United States

representing negative inflows for host countries). In the United Kingdom, which also hosts a large number of United States MNEs, inflows contracted by more than a third. However, announced greenfield investment projects continued on an upward trend. The Netherlands became the largest recipient of FDI in Europe, followed by the United Kingdom and Spain.

In the United States, inflows declined by 9 per cent to \$252 billion, as a result of negative intracompany loans. However, reflecting steady economic growth, income on inward FDI increased to \$200 billion, of which \$119 billion (up 28 per cent from 2017) was retained as reinvested earnings.

Outflows from European economies increased by 11 per cent to \$418 billion. Outward investment by French MNEs more than doubled to \$102 billion, making them the largest source of FDI flows from Europe.

In 2018, announced greenfield investment projects in developed economies increased by 17 per cent, suggesting potential for a recovery of FDI. FDI in developed economies, especially Europe, is likely to rebound from the anomalously low levels in 2018.

FDI flows to the structurally weak economies remain fragile

FDI inflows to the 47 *least developed countries* (LDCs) as a group increased by 15 per cent to \$24 billion, representing 1.8 per cent of global FDI. Although FDI in African LDCs recovered from a historical low in 2017 to \$12 billion (up 27 per cent) in 2018, it stayed more than 40 per cent below the annual average of 2012–2016. In contrast, led by Bangladesh (up 68 per cent to \$3.6 billion), Asian and Oceanian LDCs recorded a new high in FDI flows (up 8 per cent to \$12 billion).

Trends in announced greenfield FDI projects suggest that the more sizeable investments will continue to target natural resources in Africa and power generation projects in Asia. Many of the larger investment recipients in both Africa and Asia expect FDI to pick up in the coming years with investments in natural resources and SEZs. The high share in LDCs of investors from developing economies compared with MNEs from developed economies is likely to continue.

After a temporary recovery in 2017, FDI flows to the 32 *landlocked developing countries* (LLDCs) declined again in 2018, by 2 per cent to \$23 billion – or 1.7 per cent of global FDI inflows. In transition-economy and most Asian LLDCs,

the decline in FDI was modest, while Latin American LLDCs experienced a more pronounced downturn. Flows to LLDCs remained concentrated in a few economies, with the top five recipients (Kazakhstan, Ethiopia, Mongolia, Turkmenistan and Azerbaijan) accounting for 56 per cent of total FDI to the group. Chinese MNEs are increasingly active sources of investment and are present in practically all LLDCs. Prospects for FDI vary according to LLDCs' level of development and industrialization, with the fastest growth expected in those with more potential for economic diversification.

FDI flows to the 28 *small island developing States (SIDS)* slipped for a second year to \$3.7 billion, with an 11 per cent contraction in the Caribbean SIDS. FDI in Asian and Oceanian SIDS stagnated at \$1 billion. FDI flows to African SIDS fell by 22 per cent to \$0.6 billion.

FDI flows into SIDS will remain fragile and dependent on few capital-intensive projects. The trends in announced greenfield projects suggest further concentration of FDI in a narrow range of industries in the services sector (e.g. business activities, hotels and restaurants). Several SIDS in Africa and in the Caribbean can expect sizeable investments in new tourism projects. In some SIDS, ongoing SEZ development could create new investment opportunities.

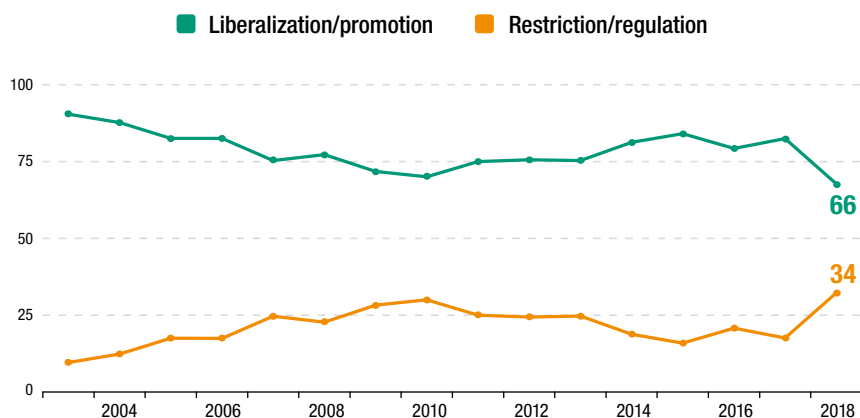
Investment policy trends

Foreign investment restrictions and regulations are on the rise

In 2018, some 55 countries and economies introduced at least 112 policy measures affecting foreign investment. Two thirds of these measures sought to liberalize, promote and facilitate new investment. Thirty-four percent introduced new restrictions or regulations for FDI – the highest share since 2003 (figure 5).

Liberalization measures affected several industries, including agriculture, media, mining, energy, retail trade, finance, logistics, transportation, telecommunication and the internet business. Developing countries in Asia accounted for approximately 60 percent of such measures. Some countries advanced the privatization of state-owned companies. Furthermore, the trend towards simplifying or streamlining administrative procedures for foreign investors continued, for example through the abolition of approval requirements or the establishment of online application portals. Also, numerous countries provided new fiscal incentives for investment in specific industries or regions.

Figure 5. Changes in national investment policies, 2003–2018 (Per cent)



Source: UNCTAD, Investment Policy Hub.

Among the new restrictions and regulations, developed countries adopted a number of measures to address national security concerns. In developing countries, measures included new foreign ownership ceilings in certain industries or restrictions on the acquisition of residential property. New local content requirements and obligations to employ local workers were also introduced, including as part of public procurement rules.

Numerous cross-border M&A deals (exceeding \$50 million) fell through in 2018 because of government interventions. At least 22 deals were blocked or withdrawn for regulatory or political reasons – twice as many as in 2017. Nine were halted for national security considerations, three were withdrawn due to concerns from competition authorities and three more were aborted for other regulatory reasons. Another seven deals were abandoned due to approval delays from host-country authorities.

Countries are reinforcing regulatory frameworks to screen foreign investment

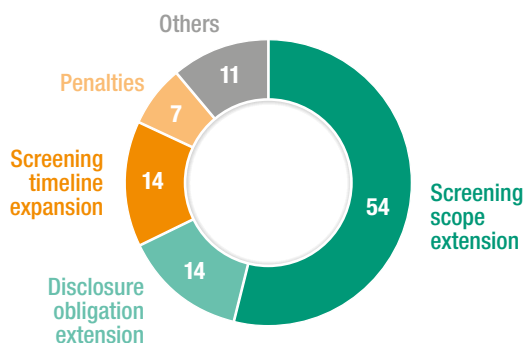
FDI screening has become more prevalent over recent years. At least 24 countries – collectively accounting for 56 per cent of global FDI stock – have a specific foreign investment screening mechanism in place. Tighter control over foreign acquisitions due to security and public interest concerns is also being addressed at regional levels.

The use of national security arguments in investment policy originated as an instrument to control foreign participation in the defence industry. It has since gradually broadened to protect other strategic industries and critical infrastructure and is now also used to safeguard domestic core technologies and know-how considered essential for national competitiveness in the era of the new industrial revolution.

From 2011 to March 2019 at least 41 significant amendments were made to FDI screening frameworks and at least 11 countries introduced new frameworks. Most of the amendments expanded the scope of screening rules by adding new sectors or activities, lowering triggering thresholds or broadening the definition of foreign investment. Other new regulations broadened disclosure obligations, extended the statutory timelines of screening procedures, or introduced penalties for not respecting notification obligations (figure 6).

Figure 6.

New restrictive FDI screening policies by category, 2011–March 2019 (Per cent)



Source: UNCTAD.

International investment policymaking remains highly dynamic

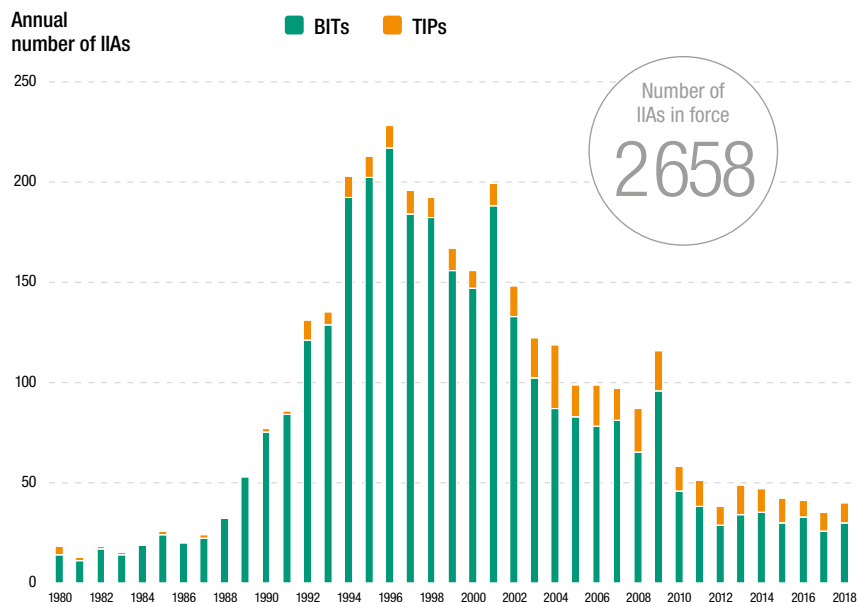
In 2018, 40 new IIAs were signed. The new treaties included 30 bilateral investment treaties (BITs) and 10 treaties with investment provisions (TIPs). The country most active in concluding IIAs was Turkey with eight BITs, followed by the United Arab Emirates with six BITs and Singapore with five treaties (two BITs and three TIPs).

Some of the new treaties are megaregional, with novel features and involving key investor countries. The new treaties brought the number of IIAs to 3,317 (2,932 BITs and 385 TIPs). By the end of the year, at least 2,658 IIAs were in force (figure 7).

At the same time, the number of IIA terminations continued to rise. In 2018, at least 24 terminations entered into effect (“effective terminations”), 20 of which were unilateral and 4 of which were due to replacements (through the entry into force of a newer treaty). This included 12 BITs terminated by Ecuador and five by India. By the end of the year, the total number of effective terminations reached 309 (61 per cent having occurred since 2010).

Many countries are developing new model treaties and guiding principles to shape future treaty making. This will have a significant impact on the global

Figure 7. | Number of IIAs signed, 1980–2018



Source: UNCTAD, IIA Navigator.

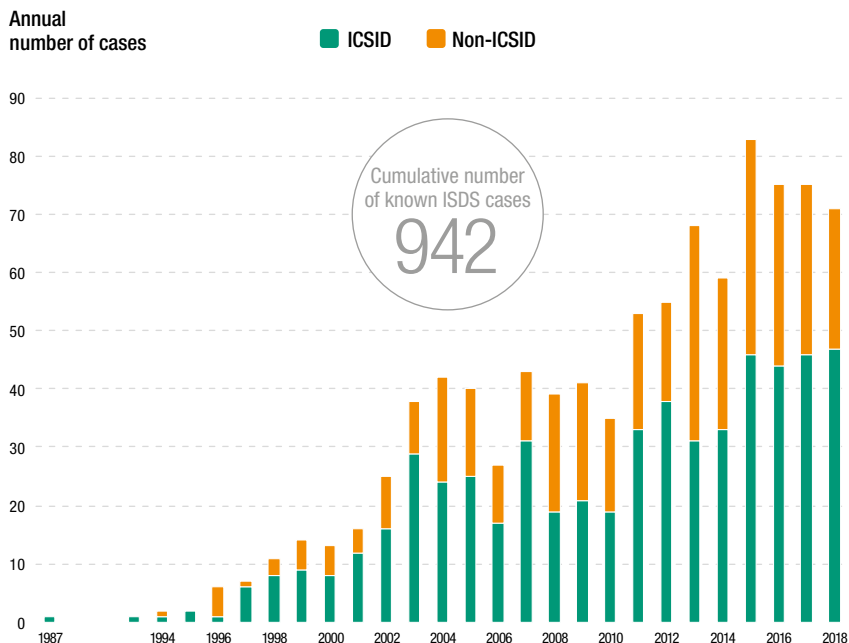
IIA regime. Many of these developments have benefited from UNCTAD's work on IIA-related technical assistance and capacity building.

The surge in ISDS cases continues

In 2018, investors initiated 71 publicly known ISDS cases pursuant to IIAs (figure 8), nearly as many as in each of the previous three years. As of 1 January 2019, the total number of publicly known ISDS claims had reached 942. Almost all known ISDS cases have thus far been based on old-generation investment treaties. To date, 117 countries have been respondents to one or more ISDS claims. As some arbitrations can be kept confidential, the actual number of disputes filed in 2018 and previous years is likely to be higher.

Over two thirds of the publicly available arbitral decisions rendered in 2018 were decided in favour of the investor, either on jurisdictional grounds or on merits. By the end of the year, 602 ISDS proceedings had been concluded.

Figure 8. | Trends in known treaty-based ISDS cases, 1987–2018



Source: UNCTAD, ISDS Navigator.

Forward-looking IIA reform is well under way

All treaties concluded in 2018 contain several reforms that are in line with UNCTAD's Reform Package for the International Investment Regime. Twenty-seven of the 29 IIAs concluded in 2018 for which texts are available contain at least six reform features. Provisions that were considered innovative in pre-2012 IIAs now appear regularly. Modern treaties often include a sustainable development orientation, preservation of regulatory space, and improvements to or omissions of investment dispute settlement. The most frequent area of reform is the preservation of regulatory space. Some recent IIAs or treaty models also contain explicit references to gender equality.

Investor–State arbitration is also a central focus of IIA reform. It continues to be controversial, spurring debate in the investment and development community and the public at large. About 75 per cent of IIAs concluded in 2018 contain at least one ISDS reform element, and many contain several.

Most of these reform elements are in line with the options identified by UNCTAD in the Investment Policy Framework for Sustainable Development. Five principal approaches emerge from IIAs signed in 2018 (used alone or in combination): (i) no ISDS (four IIAs entirely omit ISDS), (ii) a standing ISDS tribunal (one IIA), (iii) limited ISDS (19 IIAs), (iv) improved ISDS procedures (15 IIAs), and (v) an unreformed ISDS mechanism (six IIAs). Some of the reform approaches have more far-reaching implications than others.

ISDS reform is being pursued across various regions and by countries at different levels of development. In parallel, multilateral engagement on ISDS reform is gaining prominence, involving a number of institutions such as UNCITRAL and ICSID.

But comprehensive reform is only just beginning

IIA reform is progressing, but much remains to be done. UNCTAD's policy tools have spurred initial action to modernize old-generation treaties. Increasingly, countries interpret, amend, replace or terminate outdated treaties. However, the stock of old-generation treaties is 10 times larger than the number of modern, reform-oriented treaties. The great majority of known ISDS cases have thus far been based on old-generation treaties.

IIA reform actions are also creating new challenges. New treaties aim to improve balance and flexibility, but they also make the IIA regime less homogenous. Moreover, innovative clauses in new treaties have not yet been tested in arbitral proceedings. Different approaches to ISDS reform, ranging from traditional ad hoc tribunals to a standing court or to no ISDS, add to broader systemic complexity. Moreover, reform efforts are occurring in parallel and often in isolation.

Effectively harnessing international investment relations for the pursuit of sustainable development requires holistic and synchronized reform through an inclusive and transparent process. UNCTAD can play an important facilitating role in this regard.

Financial markets increasingly integrate ESG factors

Capital markets play an important role in the global investment chain. Portfolio investment is the third largest form of external finance for developing countries, and capital market practices can shape the sustainable development practices of MNEs engaged in FDI worldwide. Key actors influencing capital markets include security market regulators, stock exchanges, issuers (listed companies), asset owners and asset managers (investors). Stock exchanges sit at the centre of this web of actors and the sustainability practices of stock exchanges can be a useful benchmark to monitor trends in sustainable finance.

Recent years have shown a sharp uptake in sustainability activities among the world's stock exchanges. This upward trend is expected to continue. Public policies to promote sustainable development are being strengthened in a number of jurisdictions. Also, the exchange industry and market regulators increasingly recognize the important role that environmental, social and governance (ESG) factors can play in promoting investment in sustainable development and emerging markets.

As ESG inclusion transitions from a niche to a mainstream practice, key challenges will need to be addressed, including fully integrating sustainability throughout the investment chain, connecting upstream asset managers to downstream investment projects and expanding ESG themed financial products.

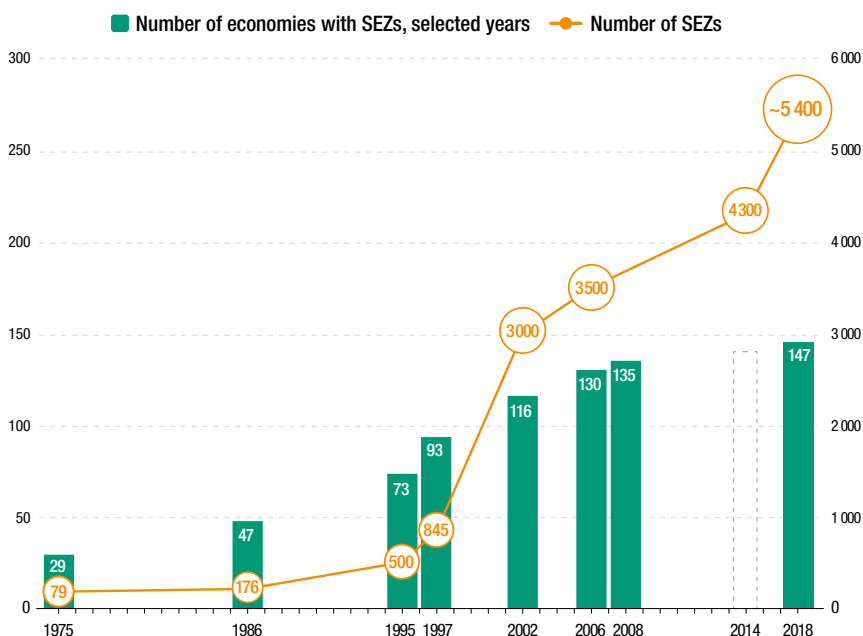
SPECIAL ECONOMIC ZONES

SEZs are spreading rapidly around the world

Special economic zones (SEZs) are widely used in most developing and many developed economies. In these geographically delimited areas, governments facilitate industrial activity through fiscal and regulatory incentives and infrastructure support. There are some 5,400 zones across 147 economies today, up from about 4,000 five years ago, and more than 500 new SEZs are in the pipeline (figure 9). The SEZ boom is part of a new wave of industrial policies and a response to increasing competition for internationally mobile investment.

Most zones offer fiscal incentives, relief from customs duties and tariffs; business-friendly regulations with respect to land access, permits and licenses or employment rules; and administrative streamlining and facilitation.

Figure 9. | **Historical trend in SEZs** (Numbers of countries and SEZs)



Source: UNCTAD.

Infrastructure support is another important feature, especially in developing countries where basic infrastructure for business outside these zones can be poor.

Zone types vary following an SEZ development ladder

There are many types of SEZs. Basic free zones focused on facilitating trade logistics are most common in developed countries. Developing economies tend to employ integrated zones aimed at industrial development, which can be multi-industry, specialized or focused on developing innovation capabilities. The degree and type of specialization is closely linked to countries' level of industrialization, following an SEZ development ladder (table 1).

Many new types of SEZs and innovative zone development programmes are emerging. Some focus on new industries, such as high-tech, financial services, or tourism – moving beyond the trade- and labour-intensive manufacturing activities of traditional SEZs. Others focus on environmental performance, science commercialization, regional development or urban regeneration.

Despite the emergence of new forms of zones linked to natural resources, aimed at domestic markets or intended as incubators for start-ups and small and medium-sized enterprises, most SEZs remain essentially a part of countries' competitive investment promotion package, together with other forms of incentives.

International cooperation on SEZ development is increasing

Zones developed with a foreign partner are increasingly common. Despite the attention that government-to-government partnership zones have attracted, the majority are built with international private zone-development firms, without formal agreements with a foreign government.

Nevertheless, formal international cooperation on zone development is a growing phenomenon. A mixture of development assistance, economic cooperation and strategic considerations is driving the development of partnership zones with the support of investor home countries. Major donor countries and multilateral development institutions have included the development of SEZs in their development cooperation programmes.

Advantages for developing countries constructing SEZs with a foreign partner include sharing development costs, tapping into the expertise and

Table 1.

The SEZ development ladder

	Zone policy objectives	Prevalent zone types
High-income economies	<ul style="list-style-type: none"> • Provide an efficient platform for complex cross-border supply chains • Focus on avoiding distortions in the economy 	<ul style="list-style-type: none"> • Logistics hubs free zones only (not industrial free zones) • Innovation and new industrial revolution objectives pursued through science parks without separate regulatory framework, or though incentives not linked to zones
Upper-middle-income economies	<ul style="list-style-type: none"> • Support transition to services economy • Attract new high-tech industries • Focus on upgrading innovation capabilities 	<ul style="list-style-type: none"> • Technology-based zones (e.g. R&D, high-tech, biotech) • Specialized zones aimed at high value added industries or value chain segments • Services zones (e.g. financial services)
Middle-income economies	<ul style="list-style-type: none"> • Support industrial upgrading • Promote GVC integration and upgrading • Focus on technology dissemination and spillovers 	<ul style="list-style-type: none"> • Specialized zones focused on GVC-intensive industries (e.g. automotive, electronics) • Services zones (e.g. business process outsourcing, call centres)
Low-income economies	<ul style="list-style-type: none"> • Stimulate industrial development and diversification • Offset weaknesses in investment climate • Implement or pilot business reforms in a limited area • Concentrate investment in infrastructure in a limited area • Focus on direct employment and export benefits 	<ul style="list-style-type: none"> • Multi-activity zones • Resource-based zones aimed at attracting processing industries

Source: UNCTAD.

experience of partner countries and foreign zone developers, and gaining preferential access to an established investor network.

Regional integration initiatives have also promoted the establishment of SEZs along regional economic corridors. Regional development zones and cross-border zones spanning two or three countries are becoming a feature of regional economic cooperation.

SEZs can make important contributions to growth and development

SEZs can help attract investment, create jobs and boost exports – both directly and indirectly, where they succeed in building linkages with the broader economy. Zones can also support global value chain (GVC) participation, industrial upgrading and diversification.

Zones are a key investment promotion tool. The advantages of clustering and co-location economies are an important attraction for investors. In many countries, the incentives, infrastructure support and business facilitation in SEZs are meant to compensate for weaknesses in the investment climate. However, zones are neither a precondition nor a guarantee for above-average performance on FDI attraction. Only about half of investment promotion agencies worldwide believe the zones in their country have given a significant boost to FDI attraction.

In many countries, zone programmes account for a major share of exports, particularly manufactured exports. SEZs have been a key component of export diversification efforts in developing countries, and they have been instrumental in improving countries' participation in GVCs. Trade costs such as tariffs, border taxes and fees, accumulate when intermediate goods are imported, processed and then re-exported in complex GVCs. By lowering such transaction costs, SEZs have become major hubs in GVCs.

Zones are often an effective tool for job creation, particularly for women. The impact of SEZ jobs in countries with high rates of unemployment and underemployment is significant. Especially in the poorest countries, SEZs can be an important avenue to formal employment.

However, none of the potential economic contributions of SEZs are automatic. The performance of many zones remains below expectations. Where they lift economic growth, the stimulus tends to be temporary: after the build-up period, most zones grow at the same rate as the national economy. And too many zones operate as enclaves with limited impact beyond their confines.

In addition, it is important to consider the social and environmental impacts of SEZs. Zone labour standards, in particular, have often raised concerns in the past. This is changing in modern zones. ESG practices are improving; more than half of the SEZs polled in an UNCTAD survey have policies on environmental standards and regulations, and some have adopted international environmental standards.

To date, few countries systematically assess the performance and impact of SEZs, and even fewer have instated mechanisms to deal with underperformance. Doing so is critical, because the turnaround of unsuccessful SEZs requires timely diagnosis, especially when there has been a significant level of public investment in zone development. *UNCTAD's SEZ Sustainable Development Profit and Loss Statement (P&L)* can guide policymakers in the design of a comprehensive monitoring and evaluation system (table 2).

Lessons learned for modern zone development

Strategic design of the SEZ policy framework and development programme is crucial. The types of zones and their specialization should build on existing competitive advantages and capabilities. Some less developed countries have sought to attract high-tech investors into SEZs to leapfrog into higher value added activities and accelerate economic growth. Yet high-tech zones in environments that lack key locational advantages for such activities – including sufficiently skilled resources, research institutions and the amenities to attract specialized foreign personnel – may not be viable. Zone development plans should be long-term and guided by the SEZ development ladder.

Zone development programmes should take a frugal approach. The SEZ Sustainable Development P&L emphasizes the need for financial and fiscal sustainability of zones, as their broader economic growth impact can be uncertain and take time to materialize.

Few countries conduct comprehensive assessments of zone benefits against costs, including initial investment expenditures and operating costs. Zones have the potential to provide development benefits beyond direct economic and financial gains, supporting economic transformation objectives, technology and skills development, and policy experimentation opportunities. These development benefits can justify public investment in zones. However, the financial and fiscal viability of zones is important for long-term sustainability. High upfront costs due to overspecification, subsidies for zone occupants and transfers to zone regimes of already-operating firms pose the greatest risks to fiscal viability. Outsourcing zone development to the private sector can substantially reduce the capital cost for governments, as well as some of the risks involved.

The success of individual SEZs depends on getting the basics right. Most failures can be traced back to problems such as poor site locations that

Table 2.

SEZ sustainable development “profit and loss statement”

Cost-benefit areas	Key elements
Direct economic contributions	<ul style="list-style-type: none"> • Attraction of FDI • Job creation • Export growth • Foreign exchange earnings
+	
Indirect economic contributions	<ul style="list-style-type: none"> • Supplier linkages beyond the zones • Indirect and induced job creation
=	
Combined economic impact	<ul style="list-style-type: none"> • <i>Additional GDP growth</i>
+/-	
Net cost of/revenue from zones	<ul style="list-style-type: none"> • Investment expenditures • Operating costs • Foregone revenues and subsidies • Income from zones
=	
Fiscal/financial viability of zones	<ul style="list-style-type: none"> • <i>Payback time of zone investment</i> • <i>Fiscal burden</i>
+	
Dynamic economic contributions	<ul style="list-style-type: none"> • Technology dissemination • Skills and know-how transfers • Industrial diversification and upgrading • Enhanced regional economic cooperation
+/-	
Social and environmental impacts and externalities	<ul style="list-style-type: none"> • Labour conditions • Environmental impact • Appropriation or misuse of land • Illicit flows
+/-	
Policy learning and broader reform impact	<ul style="list-style-type: none"> • Pilot function of zones • Catalyst function for reforms • Reduced motivation to reform
=	
Overall sustainable development impact	<ul style="list-style-type: none"> • <i>Evolution of the role of zones in the economy</i> • <i>Long-term zone transformations</i>

Source: UNCTAD.

require heavy capital expenditures or that are far away from infrastructure hubs or cities with sufficient pools of labour; unreliable power supplies; poor zone design with inadequate facilities or maintenance; or overly cumbersome procedures. The facilitation of administrative procedures for businesses and investors in the zone through regulatory streamlining and one-stop shops or single windows is a must.

Active support to promote clusters and linkages is key to maximizing development impact. Firms operating in zones can benefit from network effects and economies of scale. Zone specialization helps to promote clustering. Firms operating in the same or adjacent industries have greater scope to collaborate, pool resources and share facilities than firms operating in unrelated industries. Nevertheless, even multi-activity zones can extract some of the benefits of co-location. Firms in different industries can share common services in the zone. Pro-active identification of opportunities, matching efforts and training programmes, with firms within and outside the zone, significantly boosts zones' impact.

A solid regulatory framework, strong institutions and good governance are critical success factors. The legal infrastructure of SEZs should ensure consistent, transparent and predictable implementation of SEZ policies. The responsibilities of SEZ governing bodies should be clearly defined. The autonomy of the governing body, particularly in the context of an increasing number of private zones, is important to minimize conflicts of interest.

The choice between public, private or public-private partnership zone development models depends on the country-specific policy and legislative context and on the types of SEZ that governments aim to develop. Private sector zone development offers advantages, including a better understanding of appropriate levels of investment and facilities best suited to the zone and access to an established network of investors (tenants) in the zone.

Modern SEZs face a triple challenge

Where policymakers need to turn around struggling SEZs or to adjust zone programmes that fail to deliver on objectives, they need options for reorienting their strategic approach, reforming zone regulations and repackaging zone benefits. That need may become increasingly acute with the evolution of three key challenges: the sustainable development imperative, the new industrial revolution and the digital economy, and changing patterns of international production and GVCs.

The sustainable development agenda increasingly drives MNEs' strategic decisions and operations, which should be reflected in the value proposition that SEZs market to investors. Laxer social and environmental rules or controls are not a long-term viable competitive advantage to attract investment in zones. SEZs marketing their environmental performance (ecozones) are already emerging, and the enforcement and active promotion of high ESG standards will increasingly become a feature of SEZs.

Modern SEZs can make a positive contribution to the ESG performance of countries' industrial bases. Controls, enforcement and services (e.g. inspectors, health services, waste management and renewable energy installations) can be provided more easily and cheaply in the confined areas of SEZs. Fiscal incentives conditional not only on employment, investment or export performance, but also on a range of social and environmental indicators have the potential to become a key tool driving SEZs' ESG performance and sustainable development impact.

In line with the SDGs, that impact should include gender equality. SEZs are traditionally big employers of women, with about 60 per cent female employees on average. Some modern zones are implementing gender equality regulations, such as anti-discrimination rules, and support services, such as childcare and schooling facilities, setting new standards for SDG performance.

The new industrial revolution and the digital economy are changing manufacturing industries – the main clients of SEZs. The declining importance of labour costs as a locational determinant for investment will have fundamental implications for SEZs. SEZ development programmes will need to adapt their value propositions to include access to skilled resources, high levels of data connectivity and relevant technology service providers, potentially through partnerships with platform providers. Digital service provision by SEZ operators, e.g. through online single windows for administrative procedures, becomes an increasingly important signal to potential investors. At the strategic level, SEZs may have new opportunities to target digital firms and orient their strategic strengths in logistics facilitation towards the distribution activities in digital value chains. SEZs could also act as incubators and promote clustering and linkages with digital start-ups within and outside their confines.

Changes in patterns of international production and GVCs are a feature of the current challenging global policy environment for trade and investment,

with rising protectionism, shifting trade preferences and a prevalence of regional economic cooperation. These changes can significantly affect the competitiveness of SEZs, which function as central nodes in GVCs. International cooperation on zone development is likely to become increasingly important. The trend towards more regional rather than multilateral economic cooperation is likely to give further impetus to the development of regional and cross-border zones.

The future: SDG model zones

The sustainable development imperative is arguably the most urgent challenge facing policymakers, zone programme developers and zone managers today. The 2030 Agenda for Sustainable Development provides an opportunity for the development of an entirely new type of SEZ: the SDG model zone. Such zones would aim to attract investment in SDG-relevant activities, adopt the highest levels of ESG standards and compliance, and promote inclusive growth through linkages and spillovers.

SDG model zones could act as catalysts to transform the “race to the bottom” for the attraction of investment (through lower taxes, fewer rules and lower standards) into a race to the top – making sustainable development impact a locational advantage.

This process of modernizing zones and building SDG Model Zones can benefit from a global exchange of experience and good practices. Also, with more and more zones being developed through international partnerships, a global platform that brings together financing partners, SEZ developers, host countries, investment promotion agencies and outward investment promotion agencies, as well as impact investors, can accelerate the transition towards sustainable development-oriented zones. UNCTAD can play a leading role in establishing such a platform in connection with its World Investment Forum, and in supporting partnerships through its policy advice, technical assistance and training programmes. The key objective should be to make SEZs work for the SDGs: from privileged enclaves to sources of widespread benefits.

WORLD INVESTMENT REPORT

PAST ISSUES

- WIR 2018: Investment and New Industrial Policies
- WIR 2017: Investment and the Digital Economy
- WIR 2016: Investor Nationality: Policy Challenges
- WIR 2015: Reforming International Investment Governance
- WIR 2014: Investing in the SDGs: An Action Plan
- WIR 2013: Global Value Chains: Investment and Trade for Development
- WIR 2012: Towards a New Generation of Investment Policies
- WIR 2011: Non-Equity Modes of International Production and Development
- WIR 2010: Investing in a Low-carbon Economy
- WIR 2009: Transnational Corporations, Agricultural Production and Development
- WIR 2008: Transnational Corporations and the Infrastructure Challenge
- WIR 2007: Transnational Corporations, Extractive Industries and Development
- WIR 2006: FDI from Developing and Transition Economies: Implications for Development
- WIR 2005: Transnational Corporations and the Internationalization of R&D
- WIR 2004: The Shift Towards Services
- WIR 2003: FDI Policies for Development: National and International Perspectives
- WIR 2002: Transnational Corporations and Export Competitiveness
- WIR 2001: Promoting Linkages
- WIR 2000: Cross-border Mergers and Acquisitions and Development
- WIR 1999: Foreign Direct Investment and the Challenge of Development
- WIR 1998: Trends and Determinants
- WIR 1997: Transnational Corporations, Market Structure and Competition Policy
- WIR 1996: Investment, Trade and International Policy Arrangements
- WIR 1995: Transnational Corporations and Competitiveness
- WIR 1994: Transnational Corporations, Employment and the Workplace
- WIR 1993: Transnational Corporations and Integrated International Production
- WIR 1992: Transnational Corporations as Engines of Growth
- WIR 1991: The Triad in Foreign Direct Investment

SELECTED UNCTAD PROGRAMMES ON INVESTMENT AND ENTERPRISE

World Investment Report

worldinvestmentreport.org

World Investment Forum

worldinvestmentforum.unctad.org

**UNCTAD Investment Policy Framework
for Sustainable Development**

investmentpolicyhub.unctad.org/ipfsd

UNCTAD Entrepreneurship Policy Framework

unctad.org/en/PublicationsLibrary/diaeed2012d1_en.pdf

Sustainable Stock Exchanges Initiative

sseinitiative.org

Business Facilitation

businessfacilitation.org

Business Schools for Impact

business-schools-for-impact.org

Investment Policy Hub

investmentpolicyhub.unctad.org

FDI Statistics

unctad.org/fdistatistics

Investment Trends and Policies Monitors

unctad.org/diae

International Investment Agreements

unctad.org/iaa

Investment Policy Reviews

unctad.org/ipr

ISAR Corporate Transparency Accounting

unctad.org/isar

Transnational Corporations Journal

unctad.org/tnc



worldinvestmentreport.org

HOW TO OBTAIN THE PUBLICATIONS

The sales publications may be purchased from distributors of United Nations publications throughout the world. They may also be obtained by contacting:

United Nations Publications
Customer Service
c/o National Book Network
15200 NBN Way
PO Box 190
Blue Ridge Summit, PA 17214
email: unpublications@nbnbooks.com

unp.un.org

For further information on the work on foreign direct investment and multinational enterprises, please address inquiries to:

Division on Investment and Enterprise
United Nations Conference on
Trade and Development
Palais des Nations, Room E-10052
CH-1211 Geneva 10 Switzerland

Telephone: +41 22 917 4533
Fax: +41 22 917 0498
unctad.org/diae