

Unlocking Economic Growth: The Role of Special Economic Zones in Shaping the Middle East's New Economy

A whitepaper by  investopia

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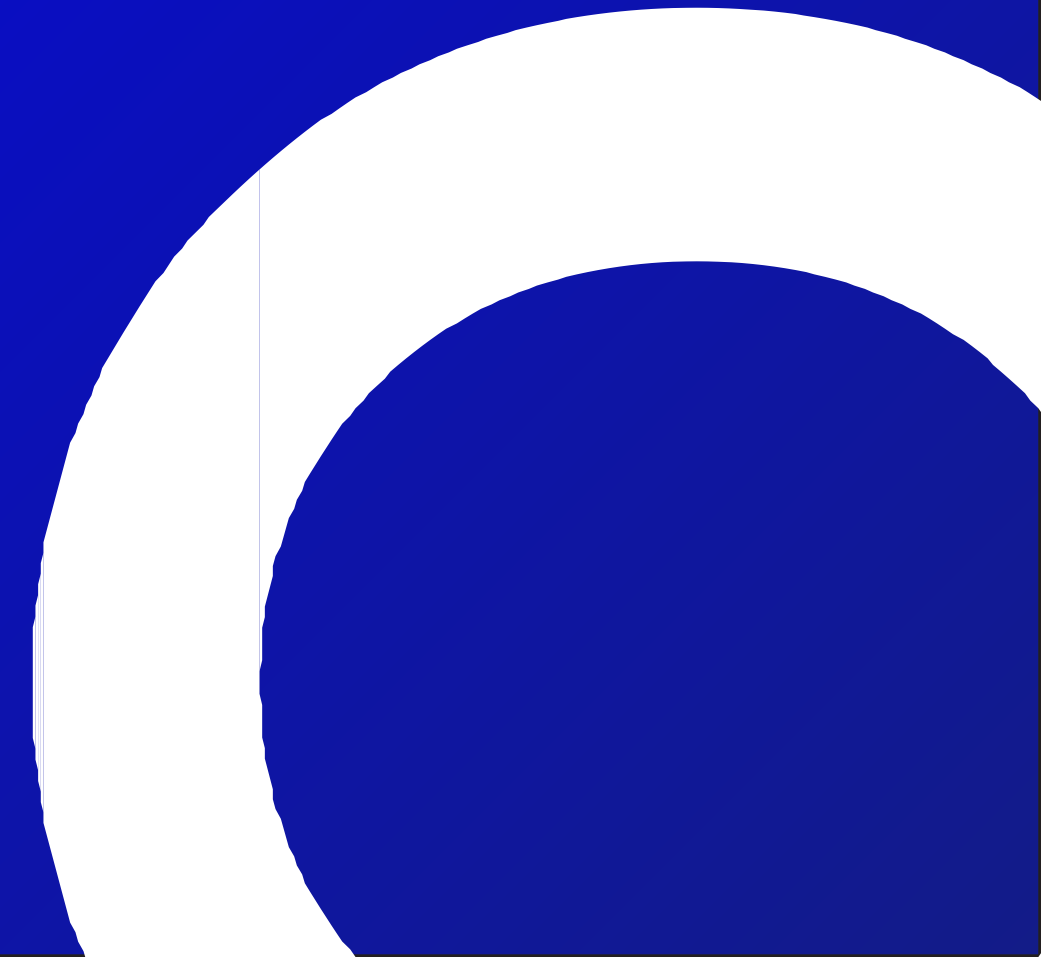
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INTRODUCTION

As the Middle East embarks on a journey of economic transformation, diversification from oil-dependent revenue models has become a strategic priority for many nations in the region. Economies within the region are undergoing significant transformations to reduce their long-standing dependence on fossil fuel revenues, expand their non-oil GDP, and generate employment opportunities for their young, educated, and growing populations. In this regard, industrials and logistics have emerged as central pillars of diversification strategies and major drivers of Foreign Direct Investment (FDI) into GCC economies. This is largely due to the region's strategic location at the crossroads of three continents, access to some of the world's busiest maritime routes, affordable feedstock and utilities, and the financial resources to invest in advanced infrastructure and technologies.

In Saudi Arabia, the National Industrial Development and Logistics Program (NIDLP) was launched with the goal of transforming the Kingdom into a leading industrial power and global logistics hub by focusing on four key sectors: industry, mining, energy, and logistics. Abu Dhabi's Vision 2030 aims to build a robust and resilient infrastructure, while Kuwait's National Development Plan 2035 seeks to modernize national infrastructure to enhance the quality of life for all citizens. Qatar, through its National Vision 2030, is working towards a more diversified economy by expanding industries and services and investing in world-class infrastructure.

With rapid urbanization, a growing young population, and global shifts toward knowledge-based economies, Middle Eastern countries are increasingly exploring innovative frameworks to foster sustainable growth and create new economic opportunities. One of the key mechanisms driving this transformation is the development and expansion of Special Economic Zones (SEZs). SEZs, broadly encompassing free trade and export zones, have gained renewed importance as crucial enablers of these national transformation initiatives. They provide potential investors with access to local and regional markets, along with the necessary infrastructure, facilities, and support services. They are designed to attract foreign investment, stimulate industrial growth, and enhance the global competitiveness of local economies. SEZs offer businesses an environment with infrastructure, tax incentives, and regulatory flexibility, providing companies with the ideal conditions to innovate, expand, and access both regional and international markets.

THE ROLE OF SPECIAL ECONOMIC ZONES IN ECONOMIC DIVERSIFICATION

The countries in the Middle East have distinct needs for industrial and sectoral advancement, regional economic integration, local development, economic diversification and inclusion, and job creation. SEZs offer substantial, yet largely unexploited, potential within the region to meet these needs.

SEZs in the Middle East were initially designed to stimulate manufacturing activity by leveraging the region's abundant low-cost land, labor, and, in some cases, raw material availability. These zones aimed to compensate for the relatively small domestic markets by focusing on export-driven growth. In the past, significant financial incentives were necessary to attract foreign investment and drive industrial expansion within these zones.

However, as global manufacturing has evolved, so have the objectives and structure of SEZs in the region. Today's SEZs reflect both the heightened competition in international manufacturing and the increasing sophistication of production processes. Additionally, they are aligned with the Middle East's broader economic diversification goals, focusing on fostering innovation, developing advanced industries, and achieving sustainable economic development. As a result, these zones now play a more strategic role in enhancing regional competitiveness, attracting high-tech industries, and supporting long-term economic transformation. These SEZs focus on developing specific industries like manufacturing, trade, logistics, and high-tech sectors. For example, zones in countries like the UAE, Saudi Arabia, and Egypt have become hubs for logistics, advanced technologies, and renewable energy, thus expanding their economic bases.

Free Zones have a substantial impact on the UAE's exports, accounting for around 40% of the nation's total exports, including re-exports. Dubai's Free Zones, in particular, contribute 60% of the city's total goods exports, highlighting their essential role in promoting trade and supporting economic growth.

The Case of Saudi Arabia

SEZs have played a crucial role in Saudi Arabia's economic diversification efforts, aligning with the goals of Vision 2030. By creating designated areas with specific economic regulations and incentives, SEZs have attracted foreign investment, encouraged the growth of non-oil industries, and fostered innovation. These zones offer benefits like tax incentives, streamlined regulatory processes, and world-class infrastructure, making them appealing to industries such as manufacturing, logistics, technology, and renewable energy.

The SEZs in Saudi Arabia have contributed significantly to the country's economic diversification efforts by targeting a wide range of sectors. The King Abdullah Economic City SEZ, for instance, is positioned on the Red Sea and enhances global connectivity and trade through its state-of-the-art infrastructure and one of the world's most efficient ports. It supports industries linked to global supply chains and facilitates smooth access to international markets. Similarly, the Ras Al-Khair SEZ is focused on developing Saudi Arabia's maritime industry. This zone supports the country's ambition of building a US\$14 billion maritime sector. Its proximity to Ras Al-Khair Port enables efficient handling of bulk cargo and supports over 100 manufacturing projects. Meanwhile, the Jazan SEZ aims to strengthen Saudi Arabia's mining sector, enhancing the country's role in global construction and processed metals markets. It taps into the region's vast port facilities and links businesses to key industries like chemicals, metals, and agriculture. The country's Cloud Computing SEZ positions Saudi Arabia as a regional hub for advanced digital technologies and supports the growth of the ICT sector. It aims to attract \$20 billion in investments by 2030, fostering innovation in data, AI, and cloud computing. Finally, the Riyadh Integrated Special Logistics Zone, which is located near King Khalid International Airport, is key to Saudi Arabia's plan to become a global logistics hub, offering fiscal incentives and strategic benefits to attract investors.

CURRENT LANDSCAPE OF SEZS IN THE MIDDLE EAST

SEZs in their modern form have existed since the 1950s, but their rapid expansion occurred around the turn of the century, driven by globalization efforts following the Cold War. In 1997, there were 845 zones across 93 markets globally, a number that surged to 5,400 zones in 147 markets by 2018.

In the GCC region, SEZs have been present since the 1990s with varying degrees of success. However, they are now being revitalized, with new mandates and, in many cases, a complete overhaul of their positioning and value propositions. This is timely, given the GCC's competitive advantage, with an estimated 40,000 hectares of land available for development in key SEZs in the coming years. With the total area designated for existing and planned SEZs in the GCC, this figure could easily exceed 100,000 hectares by 2040—an area larger than the Kingdom of Bahrain.

Across the Middle East, there are now 10 SEZs in Egypt, 16 in Jordan, 10 in Saudi Arabia, 4 in Kuwait, 3 in Bahrain, 2 in Qatar, 47 in UAE and 5 in Oman.

There are three broad types of SEZs in the region: those focused on manufacturing, logistics, services, or a combination of the three. These zones are positioned based on five key factors: location, competitive industrial infrastructure, incentives, administrative efficiency, and trade facilitation. An example of a zone based on strategic location is the Jebel Ali Free Zone Area (JAFZA), known for its multimodal connectivity. It hosts the Jebel Ali Port, which is linked to a network of 150 direct ports of call, offers a sea-air cargo transfer time of just one hour via a virtual corridor, and enables road transit to any destination within the GCC in 2 to 3 days.

Despite these advantages, success is not guaranteed, as competition both globally and within the region is intensifying, and these factors have become basic requirements. A UNCTAD Investment Promotion Agency survey reveals that only 35% of free zones are fully or adequately utilized, with the rest being significantly underutilized. In the GCC, it is estimated that only about 25% of available SEZ land has been developed, and only two SEZs—Jafza and Hamriyah, both in the UAE—have developed more than 75% of their total designated area.

Case Study: Masdar City

In the case of UAE, Masdar City is a key player in Abu Dhabi's transformation, advancing the emirate's "falcon economy" vision, which aims for a diversified and sustainable future. As Abu Dhabi emerges as a global leader in sustainability, Masdar City combines innovative technologies with environmental stewardship, playing a crucial role in the UAE's Net Zero 2050 strategy. This reflects the broader trend of Special Economic Zones (SEZs) in the Middle East, where such initiatives are pivotal in shaping the region's new economy by promoting sustainability and economic diversification. Masdar City is a global hub for sustainability and innovation, driving the UAE's economic diversification while prioritizing environmental responsibility. With 21 LEED Platinum-certified assets and more in development, it is one of the world's largest clusters of such buildings. Notably, it includes the first net-zero commercial building, which generates 100% of its energy on-site.

Masdar City has formed strategic partnerships with key government bodies, including the Abu Dhabi Department of Economic Development, Abu Dhabi Global Market, and the Abu Dhabi Investment Office. These collaborations support initiatives like the AgriFood Growth and Water Abundance (AGWA) project within Masdar City's agri-tech cluster. Similarly, the Smart and Autonomous Vehicles Industries (SAVI) initiative is part of the mobility cluster, both of which are vital to Abu Dhabi's economic development. Furthermore, partnerships with the Department of Health and Mohamed Bin Zayed University of Artificial Intelligence are enhancing the life sciences and AI clusters.

Masdar City is home to a growing number of AI specialist companies, contributing to an anticipated \$15.7 trillion increase in the global economy by 2030 and \$320 billion in the Middle East.

As a leading innovation hub in the region, Masdar City, alongside its partners, will continue driving advancements in key sectors that also align with the UAE's goal of boosting the industrial sector's contribution to the nation's GDP by AED 300 billion by 2031.

POLICY FRAMEWORKS, CHALLENGES AND OPPORTUNITIES FOR SEZS IN THE NEW ECONOMY

Effective Monitoring and Evaluation (M&E) should be a key element of SEZ policy in the Middle East, particularly if zones are used as testing grounds for new policies. To effectively manage SEZs and refine their regulations, policymakers need to establish robust M&E systems. This approach allows them to use SEZs as platforms for experimenting with economic policies, identifying successful strategies before implementing them on a larger scale across the region.

SEZ M&E units can utilize various tools to gain a comprehensive understanding of zone activities. Administrative data, especially from tax and customs records, can help track investment, exports, and the ratio of imported to domestically sourced inputs. Additionally, management committees in many zones require firms to report on employment and output. However, ensuring data accuracy should not lead to increased bureaucracy. To avoid redundant reporting, line ministries should collaborate to streamline the process and reduce duplication.

Case Study: China

China has implemented regular evaluations of its SEZs, including Hi-Tech Development Zones (HTDZs) and Economic and Technological Development Zones (ETDZs). The government monitors zone performance in both static (standalone) and dynamic dimensions, incorporating various metrics to assess the zones' shift toward higher-skilled and higher value-added industries over time. This ensures that the zones are driving structural transformation, rather than remaining hubs for low-cost or labor-intensive industries.

The evaluation of Economic and Technological Development Zones (ETDZs) in China is based on a set of metrics, which include static performance indicators, spillover indicators and transformation indicators.

The Ministry of Commerce conducts an annual assessment of ETDZs using these metrics and publishes a ranking of the top 30 zones in categories like industrial capacity, innovation, FDI, and foreign trade to encourage competition.

SEZs can create significant positive spillover effects, which governments should encourage through supportive policies. SEZs can enhance productivity both within and beyond their boundaries by generating positive externalities for businesses through various channels. Soft policies, such as connecting zone investors with local suppliers or promoting on-the-job training programs, can help maximize the economic benefits of SEZs for the host country. On the business relationship front, one option is to reduce bureaucratic hurdles to make it easier for domestic firms to "export" to SEZs. Another strategy could involve creating a Local Content Unit— a dedicated team that connects foreign investors with appropriate domestic suppliers or provides training to help local firms meet the quality and technical standards required by foreign direct investment (FDI) companies. On the labor side, governments can establish vocational training centers for workers within SEZs, with input and support from the firms operating there. In multinational companies where senior expatriates and local managers collaborate, language barriers may limit knowledge transfer. Therefore, offering language training could further enhance the potential for spillovers.

FUTURE OUTLOOK AND RECOMMENDATIONS

Going forward, it is crucial to shift the focus from a competitive mindset to one centered on the investor perspective. SEZs often design their offerings, particularly incentives, based on what their direct competitors provide to attract or retain tenants. This can lead to replicating service and pricing structures without a thorough understanding of their unique value proposition aimed at investors and targeted industries. In reality, investors develop business cases and evaluate expected outcomes holistically, rather than considering each aspect in isolation. SEZs should focus on gaining deep insights into how investors perceive their offerings and identify the elements that hold the most value. Feedback from existing tenants can be particularly revealing and play a key role in shaping future strategies for these zones.

Investors also prefer a clear and stable regulatory and operating environment over one that is constantly changing, even if the changes are advantageous. They require confidence in their business plans and cash flow projections. Therefore, a reliable regulatory framework and strong governance are critical factors for success.

Allowing government agents within SEZs in the Middle East greater autonomy from their line ministries could spark a shift in mindset from the ground up. With increased engagement with investors, officials may begin to see their role as facilitators of economic activity rather than merely processing permits and paperwork. This approach can, in turn, motivate SEZ authorities to be more proactive and innovative in implementing reforms.

SEZs in the Middle East are increasingly being integrated into broader regional and global supply chains. As infrastructure investments in the region grow, particularly in logistics, ports, and airports, SEZs will benefit from enhanced connectivity, making them key players in global trade routes. The success of SEZs in the new economy will depend on developing local talent and upskilling the workforce. Vocational training centers, partnerships with global universities, and initiatives focused on education in high-tech fields will be central to the growth of SEZs, ensuring they have access to the skilled labor necessary for advanced industries.

In the context of the new economy in the Middle East, SEZs should focus on addressing specific economic challenges that cannot be resolved through other means. These barriers to growth are often shaped by a country's regulatory landscape, stage of development, and factors that define its comparative advantage. Therefore, the decision to create an SEZ should be supported by a clear framework that explains why such zones are an effective policy solution for overcoming these obstacles.

Several sectors appear particularly promising for SEZs in the new economy of the Middle East, driven by the region's diversification strategies, technological advancements, and global economic shifts. Key sectors include AI and blockchain, cybersecurity and cloud computing, solar and wind energy, and energy storage and smart grids. Given the region's abundant solar resources, SEZs focused on renewable energy development are becoming pivotal. As part of the transition to sustainable energy, SEZs could attract companies developing energy storage solutions and smart grid technologies, key to supporting the region's renewable energy ambitions.

At the same time, SEZs focusing on Industry 4.0 will benefit from attracting advanced manufacturing companies. Robotics, automation, and 3D printing are increasingly being integrated into manufacturing processes, offering efficiency and customization in sectors like aerospace, automotive, and healthcare. SEZs focusing on life sciences and healthcare are also promising as governments invest in localizing pharmaceutical production and developing biotechnology sectors to meet regional and global demand.

Given the Middle East's challenges with arid land and water scarcity, SEZs focused on agricultural technologies, such as vertical farming, precision agriculture, and water-efficient techniques, are crucial. These zones could drive innovations in food security and sustainable farming. The region's growing focus on sustainable food sources presents opportunities for SEZs to host firms specializing in aquaculture, aligning with the food security goals of nations like the UAE and Saudi Arabia.

The Middle East's focus on tourism as a growth sector, particularly in countries like Saudi Arabia (with projects like NEOM and The Red Sea Project) and the UAE, offers opportunities for SEZs to support luxury tourism, hotel management, and tourism technologies.

CONCLUSION

As the Middle East transitions from an oil-reliant economy to a more diversified one, the role of SEZs is becoming increasingly pivotal. By fostering innovation, attracting foreign investment, and driving industrial diversification, SEZs serve as key instruments for transforming economies traditionally dependent on hydrocarbons. However, their success hinges on strong regulatory frameworks, well-planned infrastructure, and alignment with broader economic reforms. SEZs are not standalone solutions but powerful catalysts that, when integrated into a larger strategy, can propel the region toward sustainable, long-term development and economic resilience.

In this regards, policymakers must balance short-term goals, such as attracting foreign direct investment and creating jobs, with long-term reforms aimed at fostering economic development, financial independence, and supply chain resilience. To achieve this, SEZs will require new operating and partnership models that generate alternative revenue streams, reduce public spending, and enhance service delivery.

Ultimately, SEZs are not a substitute for a well-functioning, diversified economy. Their success largely depends on the broader economy's readiness for transformation and growth. SEZs should be viewed as a strategic tool to cultivate the conditions for broader economic expansion, serving as a catalyst for a country's long-term development.



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