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ROLE OF SEZS IN ATTRACTING FDI IN SOUTH ASIA:A CASE STUDY OF PAKISTAN AND BANGLADESH

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Abstract
Special Economic Zones (SEZs) are established around the world including South Asia to achieve the policy goals of any state regarding economic development through Foreign Direct Investment (FDI). FDI helps states to increase exports, employment generation, and many more to improve economic indicators. For developing countries, SEZs have become the prime source of attracting FDI. Pakistan and the Bangladesh both are the South Asian States and ambitiously working on establishing SEZs to attract FDI for last two decades but they are facing political, economic and legal challenges to get their targets. A rich material is available on FDI and economic development, but much research has overlooked defining the relationship between SEZs, FDI, and economic development in developing countries of South Asia, particularly Pakistan and Bangladesh. This article mainly focuses on examining the role of SEZs in promoting FDI for economic development in Pakistan and Bangladesh. The study uses qualitative approach to analyse the importance of SEZs in attracting FDI in both countries. Data is collected through desk-research method that include books, online reports, online journals and websites. The study finds that SEZs have played a significant role in attracting FDI in Pakistan and Bangladesh. The study also highlights the challenges faced by SEZs in both countries, including infrastructure constraints, bureaucratic hurdles, and security concerns. The article concludes with the policy recommendations that suggest strategies to increase the effectiveness of SEZs in increasing FDI in South Asia.

Keywords: SEZs, FDI, Pakistan, Bangladesh, South Asia, Economic Development, Economic Growth, etc.

Introduction
SEZs are specially designated areas with relaxed and flexible business policies and a conducive environment for investment that includes tax incentives, streamlined regulations, and good infrastructure to attract investors from local as well as foreign markets. The governments provide all of these policy structures to attract FDI in their respective countries. In contemporary times, irrespective of their macroeconomic system, many states have emerged as economic powers due to their effective SEZs' policy structure. The success stories of such countries like China, South Korea, Thailand, Taiwan, and Hong Kong actually encouraged the developing countries to adopt this pattern for their rapid economic development. Pakistan and Bangladesh both are prominent countries of the South Asia and lie under the status of developing countries due to their low saving rate, instable political system and low economic growth rate. This study mainly focuses to analyze the role of SEZs in the attraction of inward FDI in Pakistan and Bangladesh. This study consists of three sections. First section of this study defines the concepts of SEZs and FDI and explore the logical relation between both of them. Second section of this study analyzes the role of SEZs in attracting FDI in Pakistan and Bangladesh and third section deals with the challenges and hurdles both countries are facing to attract the FDI through their SEZs in their respective countries. The study concludes with findings and suggestions.

The Concept of SEZs
SEZs are specially designated and geographically defined areas where businesses and business units operate with different regulations and incentives than those applicable to the rest of the country. In such zones, governments are responsible for creating a conducive

business environment to attract domestic as well as foreign investment [(Bost, 2019); (UNCTAD, 2019)]. These zones are of various types, but the SEZ is a blanket term used for all kinds of specialized zones. These zones allow the establishment of a wide range of industries, like the manufacturing sector, logistics, services, and domestic and international trade. It was disseminated around the globe due to its special features or objectives, such as attracting business investment, promoting good infrastructure, and establishing a platform for rapid economic growth to deliver better public services and enhance social cohesion. Today, the developing states are more inclined towards this strategy to establish such zones to achieve their own targets, like attracting FDI, promoting industrialization, diversifying exports and rapid economic growth in their respective countries [(Aziz, 2025); (BOI, 2020); (PBIT, 2018)]. SEZs are advantageous in multiple ways for the state itself, businessmen, and investors. The most important advantage is that it becomes an anchor for attracting FDI in the country. Then creating employment opportunities, encouraging industrial growth, transferring technology, enhancing productivity, increasing exports, capacity building, skill development, development of local brands, development of vendor industry and supply chains, logistics development, import substitution, and GDP growth contribution. These zones provide many benefits to developers, investors, and business enterprises in the form of tax incentives, tax holidays, free imports, and many more.

The Concept of FDI

The term FDI refers to an investment by an individual or a company into the business or enterprise in another country. It also involves a significant influence and control over business operations. It is exemplified as a multinational company establishing a manufacturing plant in a foreign country or a corporation acquiring a foreign based business or subsidiary. Antal defines as "the purchase of an interest in a company by an investor located in another country" (Antal, 2024). It also refers to "an ownership stake in a foreign company or project made by an investor, company or government from another country" (Hayes, 2024). It is generally used to describe a business decision to acquire a substantial stake in a foreign business or to buy its shares to expand operations to new regions. FDI investors usually have controlling positions in local firms or joint ventures to be actively involved in the management of the company. The investment also involves the expansion of the company's footprint, the acquisition of a source of material, or the development of a multinational presence. This term not only covers the stock of the investments in foreign countries, but it also has become a key element in global economic integration because it creates durable, long-lasting, and robust connections among the economies.

In its broader sense, FDI includes merger and acquisition, building of new facilities, reinvestment of profits earned from overseas operations and intra-company loans. While in its narrow sense, FDI refers just to building new facility and lasting management interests in an enterprise operating in an enterprise that operates other than that of the investor. FDI is actually the sum of equity capital, short-term capital, and long-term capital and also involves participation in management, joint venture, transfer of technology and expertise. It has two main types that define its investment flow, one is called inward and the second is outward FDI.

Inward FDI is defined as investment made by the foreign investor in the company of another country or foreign capital invested in local resources while outward FDI is defined as investment in a company of a foreign country or local capital invested in foreign country (Statistiken, Jan 2024).

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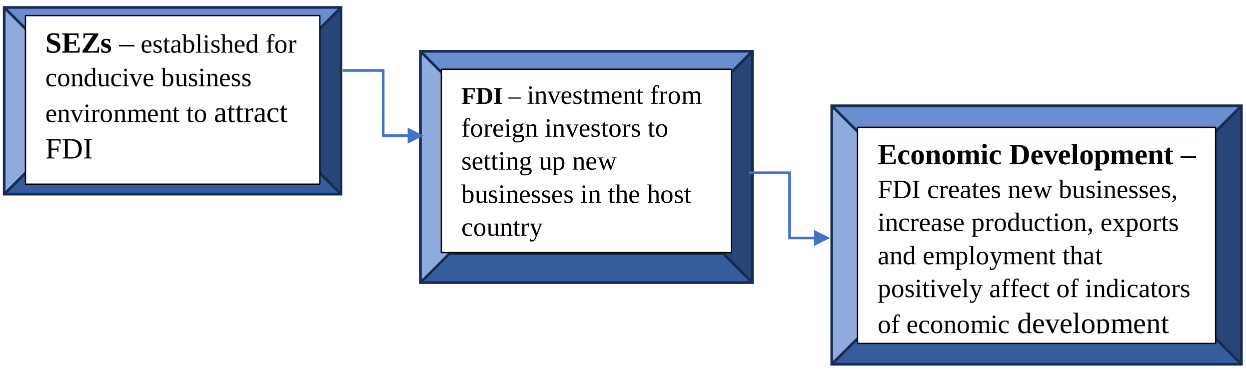
Importance of FDI in Economic Development

Several economists have highlighted foreign direct investment (FDI) as a crucial driver of economic development these include economists like de Mello, Dunning, and Kojima. They argue that FDI contributes to economic growth by facilitating technology transfer, enhancing managerial skills, and boosting productivity (Mello, 1999). Additionally, FDI can lead to capital accumulation and the creation of local businesses through knowledge spillovers. Even numerous researches proved that FDI and economic growth have been positively correlated (Rodríguez-Clare, 2009). Basically, FDI makes the international trade quite easy. It leads to increase industrialization and create new job opportunities in the host country. It also promotes the development of human capital by skill and training spillover within the investing country. Foreign investors, to get the tax benefit, transfer their business and production unites from their parent country to host country. They bring modern equipment to increase the productivity of workforce, and help to reduce disparities between costs and revenues. In short, FDI helps to increase the income of the host country.

Now, it is inevitable to answer the question that why countries are establishing SEZs if all of these benefits are due to FDI.

Link between SEZs, FDI and Economic Development

Economic development is crucial for every country in this world, and to attain it, every country struggles hard. The establishment of SEZs is the result of the experimentation of states (usually closed economies) with the economic systems to grow rapidly with different (from the rest of the country) rules and incentives in that particular zone within that country's borders. SEZs are those special zones in which investors can get the leverage and incentives to invest even in closed economic systems. As defined above, these zones are specially designated to provide more and more relaxed policies to do business without disturbing the overall macroeconomic system of that state. Therefore, it could be said that SEZs are the key tool to attract FDI that stimulate the economic growth of the country.



Source: developed by researcher

Role of State in Attracting FDI

States play a very significant and crucial role in attracting FDI in SEZs.

- States and governments are responsible for drafting policies for these zones that made investors interested in their zones and ensure a conducive business environment.
- States offer tax incentives, tax breaks, tax exemptions and various reductions that attract the foreign investors.

- States facilitate the streamlining of procedures and regulations to facilitate various business operations.
- States invest in the development of infrastructure like utilities, transportation and telecommunication etc.

Other than these states also provide its support and services to the SEZs. These include following:

- States establish one-stop shop, that is a single point of contact to facilitate the processes of investment for the foreigners.
- States actively promote their SEZs and benefits associated with them to increase the attraction.
- After the process of establishment and operations, state still provide support to foreign investors as ‘aftercare services.
- It is the prime responsibility of the government to ensure stability and security. A stable economic system, assurance of the protection of property rights, and a secure environment for their operations are inevitable for the inclination of foreign investors.

When a state plays such an important role (as described above), foreign investors find it far more appealing and are encouraged to invest in SEZs, which eventually boosts the economic development.

FDI in South Asia

South Asia is one of the world’s most diverse region and it is evident from its history that five South Asian states have been consistently reforming their macro-economic policies that emphasized the market economy integration of their economies with rest of the world. In 1980s and 1990s, the South Asian states realized that ‘Open-Trade policies’, favorable investment climate often fostered by trade liberalization tend to attract higher level of FDI in respective countries [(Bhagwati & Srinivasa, 1975); (Albahouth & Tahir, 2024); (Yeboah, Baffour, Chibalamula, & Atiso, 2025)]. Many experts claimed that FDI and open economy and trade policies are fundamental drivers of economic growth, particularly in global integrated economies. It fosters economic growth through mechanisms such as competition, technology spillovers, and human capital development. Similarly, openness of trade and economy characterized by the low barriers on trade, and liberalized policies enhances specialization, innovation diffusion and efficiency (Yeboah, Baffour, Chibalamula, & Atiso, 2025).

So, in 1990s, all the five states of South Asia (India, Bangladesh, Sri Lanka, Nepal and Pakistan) followed these patterns, adopted export-oriented economic growth model and enjoyed higher economic growth except Pakistan due to internal conflicts, political instability, social insecurity and interrupted business climate (Agrawal, 2000).

FDI and its Impact in Pakistan and Bangladesh

Pakistan and Bangladesh are two independent states of South Asia that share the same economic and political history because, previously, Bangladesh had been part of Pakistan. In 1947 Pakistan got independence from India, having two wings: East Pakistan and West Pakistan. The secession of East Pakistan from West Pakistan occurred in late 1971, and it emerged as an independent state with name of Bangladesh. Initially, Bangladesh followed the same policies as Pakistan, and similarly to Pakistan, Bangladesh also adopted an export-oriented growth model of economic development in the early 1980s.

Though there was a trend of closed economy in South Asian states in the 1960s and 1970s, where the FDI was allowed in a restrictive manner to protect the local producers. Yet, from the early 1980s, South Asian countries started to adopt export-oriented policies to attract FDI to their respective countries. Pakistan and Bangladesh were also included in those South

Asian countries that opted for export oriented economic growth policy for economic development (Sahoo, November 2006). In the meantime, countries with export-oriented growth policies have introduced many market reforms, trade liberalization policies, and intense competition for FDI, which reduced restrictions on foreign investment and expanded the scope for FDI in most sectors. Despite all of these efforts, in the last two decades of the previous century, the South Asian countries individually and jointly received low FDI than other developing Asian countries (Sahoo, November 2006). The same case was with Pakistan and Bangladesh. That was the era when South Asian states reviewed their macroeconomic policies to meet the requirements of the time. They also realized that, alongside the upgraded technologies and policies, they also needed to have links with the integrated globalized production system through participation in Multi-National Corporations (MNCs). So, they decided to liberalize their economies.

Thus, Sri Lanka became the first country in South Asia that liberalize its economy in 1977. Pakistan and Bangladesh followed it and liberalized their economies in the 1980s.

Role of State in Attracting FDI in Pakistan

At the time of independence, Pakistan was mostly relied on the agrarian sector and adopted the 'Import Substitution Policies' for its economic growth. The main focus of the government was to develop and strengthen the public sector due to various limitations in the private sector's capital in Pakistan. But, the significance of industrial sector in attracting investments cannot ignored. Therefore, in 1960s, Pakistan started its journey towards industrialization with 'Industrial Estates' (IE). In 1984, Pakistan announced its industrial policy that gave equal plank to the public and private sectors. In the late 1980s, Pakistan started to open up its economy and also liberalize the policies regarding FDI. In 1989, a new industrial policy was introduced that recognized the importance of private sector. That policy package also introduced some regulatory measures that helped to improve business environment in general and to attract FDI in particular. The 'Board of Investment' was set up which provide the facility of 'One-Window' to made it easy to establish new industries.

In November 1997, government announced another 'New Investment Policy' with the main objective to enhance FDI in industrial base expansion. It included major policy initiatives to attract FDI and opened up to the sectors other than manufacturing like agriculture, infrastructure, tourism, software development, construction, electronics, engineering, and services etc. Since 1997, "attractive tariff and tax incentives have been given to foreign investors. Remittances of royalties, technical and franchise fees, capital, profits and dividends are allowed. Further, foreign investment is fully protected through the Foreign Investment (Promotion and Protection) Act 1976, Protection of Economic Reforms Act 1992 and Foreign Currency Accounts (Protection) Ordinance, 2001" (Sahoo, November 2006). However, a major problem prevailed in the labor laws. In Pakistan, labor laws are considered complicated and over-protective, and discouraged job creation (Sahoo, November 2006). Therefore, the expected results of economic development through liberalization were difficult to achieve. In 2012, Pakistan adopted the Chinese model of SEZ, and all the existed EPZs converted into SEZs under the SEZs Act of 2012. This act has more liberalize policies and also grant more facilities and privileges to the investors. After the establishment of SEZs, Pakistan's level of FDI began to rise due to its flexible policies and attractive incentives for investors. Up till 2023, Pakistan signed 53 'Bilateral Investment Treaties' (BITs) with 48 countries to facilitate, promote, and protect foreign investment. Moreover, Pakistan has established twenty-seven SEZs till 2024, but their performance cannot be measured properly because they are claimed to be still in the development phase.

Role of State in Attracting FDI in Bangladesh

Bangladesh also started to open up its economy in late 1980s. In fact, in late 1980s and whole 1990s, Bangladesh introduced a series of measures and liberalize its FDI policy framework. However, in the first decade of twenty first century, Bangladesh liberalized its industrial policy, improved its regulatory and investment environment, abolition of performance requirements, and allowance of full foreign-owned joint ventures. Especially since 1996, new sectors have been opened up for investment, including the telecommunication sector. It encouraged all industrial activities excluding those on the list of reserved industries, such as the production of arms and ammunition; forest plantation and mechanized extraction within the bounds of a reserved forest; production of nuclear energy; and printing and minting fresh currency notes. Such investments may be undertaken either independently or through joint ventures, either with the local, private, or public sector. The capital market also remains open for portfolio investment.

The policy framework for foreign investment in Bangladesh is based on the Foreign Private Investment (Promotion and Protection) Act, 1980, which provides measures for the non-discriminatory treatment and protection of foreign investment. In addition, government also liberalized its industrial and investment policies to reduce bureaucratic control over the investment in private sector and to open up many new areas. The provision of incentives also increased the attraction of the investors, some of the major incentives includes "tax-exemptions for power generation, import duty exemptions for export processing, an exemption of import duties for export-oriented industries, and tax-holidays for different industries. Double taxation can be avoided by foreign investors on the basis of bilateral agreements. Facilities for the full repatriation of invested capital, profit and dividend exist" (Sahoo, November 2006). Furthermore, Bangladesh also recognized the importance of 'Intellectual Property Rights' for the attraction of FDI. Bangladesh became a member of 'World Intellectual Property Organization' (WIPO) in 1985 and also signed the Paris Convention on Intellectual Property' in 1991. Moreover, the labor laws in Bangladesh and very clearly defined and state about the formation of their unions, registration, and election of 'Collective Bargaining Agents' (CBAs) to negotiate their demands with the management. Even the laws about wages, disputes, working conditions, and hiring of foreign nationals (that should not exceed 15 % of the total number of employees). Shortly, it could be said that Bangladesh took considerable steps to reform and liberalize its economy to effectively attract FDI. With low labor costs in SEZs and almost no restrictions on the exit and entry of foreign investors, it is moving towards becoming an attractive destination for FDI in South Asia.

FDI in South Asia – Pakistan and Bangladesh

FDI inflow in Pakistan and Bangladesh has great significance in assessing the performance of SEZs. But unfortunately, both countries lack updated data about the SEZs performance and FDI inflow on their respective local and national websites. International institutions like the World Bank, the IMF, ADB, etc., has stopped their analysis and investigations due to irregularities in the available data. Therefore, results have been extracted from the data provided on some national banks' websites and online published reports.

As it is discussed in detail in the previous section, Pakistan's regulatory framework despite of its various reforms is still cumbersome and made it difficult to perform well. While Bangladesh has a flexible regulatory structure, easy and clear policies, therefore, its performance considered better than Pakistan.

In Pakistan, FDI averaged $157.87 Million from 1997 until 2025, reaching an all time high of $ 1262.90 Million in the June of 2008 and a record low of $ -390.90 Million in October of 2018. In comparison to this, FDI in Bangladesh averaged $ 1177.45 Million from 2002 to

2023, reached an all time high of $ 2650.00 Million in 2019 and a record low of $ 276.00 Million in 2004 (TradingEconomics, Bangladesh Foreign Direct Investment, 2023). However, all this data is about the over all FDI of the country in recent years and its contribution from SEZs is given in the table below:

Table: FDI and SEZs' FDI in Pakistan and Bangladesh

Country	**Total FDI Inflow**	**Contribution of SEZs' FDI**	**Percentage**
Pakistan	Approx. $1.3 Billion	Modest Contribution	5 - 10 %
Bangladesh	Approx. $3.84 Billion	Notable Contribution	15 %

Source: developed by researcher data is taken from [(Chakraborty & Haripiya Gundimeda, 2017); (IBEF, 2024);

In February 2025, Pakistan's FDI has increased by $ 94.70 Million (TradingEconomics, 2025).While in Bangladesh, in 2024, FDI is increased by $ 300.00 Million (CEIC, 2024) and Chowdhury Ashik Mahmud Bin Harun, Executive Chairman of the Bangladesh Investment Development Authority (BIDA) said that at the Bangladesh Investment Summit 2025, it is declared that Bangladesh's investment worth 3100 crore Tk (Star, 2025). These figures show the ups and down in the FDI inflow in Pakistan and Bangladesh, and it was also clear that Bangladesh's performance in this regard relatively remained better than Pakistan.

Challenges to Attract FDI in Pakistan and Bangladesh

The SEZs in Pakistan offer international investors a specialized location to launch their businesses as well as assurance of consistent regulations and favourable business environment. However, these SEZs didn't prove to be so-special in attracting foreign investment. There are many hurdles and challenges that hinder FDI.

High/Strict Regulatory Restrictions:

Pakistan and Bangladesh both have high regulatory restrictions that delayed the processes for investors and affect the efficiency of the SEZs. It is also due to the fact that these zones are not insulated from overall business climate of country. Complex approval procedures, registration and licensing processes coupled with bureaucratic hurdles and legal challenges are equally a barrier to investment in these economic zones as prevalent in rest of the country. Presently, it takes 256 days for a foreign company to establish a set up in Pakistan and complete all processes involving several institutions i.e. Board of Investment (BOI), Securities and Exchange Commission of Pakistan (SECP), Federal Board of Revenue (FBR), State Bank of Pakistan (SBP) and relevant regulatory bodies. This time period is far longer than 24-hour approval time in the international market (BOI, 2020).

Weak Institutions and Lack of Transparency

Pakistan and Bangladesh's institutional structures are not only complex but also cumbersome; this is due to the weak institutionalization in both countries. The institutions in both countries are mostly unable to provide protection to foreign investors. The functioning and processes in institutions lack transparency, which prolongs the functioning processes and makes it difficult to proceed.

Corruption and Political Instability

Pakistan and Bangladesh both face the challenges of deep-rooted corruption in their institutional and administrative setups. This has led to confusion and a trust deficit in both countries. Further, political instability in both states also has the same impact.

Financial and Infrastructural Constraints

Both Pakistan and Bangladesh are developing countries and often suffer from the crisis of having 'limited finance,' and therefore, governments are unable to provide the best infrastructure in SEZs. These constraints also contribute to loosening the interest of investors in both countries' SEZs.

Human Resources

The human resources of both states are different. Pakistan has more potential in this regard than Bangladesh. Pakistan has a young population; around two-thirds of the population falls within the age group of 15 to 30. While Bangladesh has a larger old-age population, therefore, investors have difficulty finding young labour in Bangladesh.

Internet Access and One-stop shop

This is a major challenge for both countries to facilitate investors in this respect because , may be SEZs' location is not favorable for communication and connectivity. The provision of the internet and easy access to it is limited in many areas of Pakistan and Bangladesh. It is the main reason that government are unable to provide one-stop shop services to the foreign investors that lessen their interest to make investment in these countries.

These challenges have sinister effects on the FDI inflow in both countries. If the governments of both countries became target-oriented towards the resolution of these challenges, then the SEZs of both countries would contribute to the overall economic development of South Asia.

Findings

This study finds that SEZs play a significant role in the attraction of FDI to Pakistan and Bangladesh.

- Both countries have experienced many ups and downs in FDI inflows since the establishment of SEZs in their respective countries.
- In 1980s and 1990s, both countries reviewed their policies and liberalize their economic policies.
- In the recent yesteryears, the performance of Bangladesh in attracting FDI remained relatively better than Pakistan.
- The higher and cumbersome regulatory structures in both countries and especially in Pakistan delayed the functioning and performance of SEZs regarding FDI inflow.
- Labor Laws are clearly defined in the reforms of 1980s and 1990s in Bangladesh and it helps to facilitate the labor and investor while Pakistan's reformed policies still have flaws and hinders the creation of employment opportunities.
- Bangladesh is a smaller country and haves less population than Pakistan but its performance is relatively better than Pakistan especially in its RMG sector.
- It is due to the older age population in Bangladesh that performance of other sectors is not as fruitful as they have expectation.
- Pakistan has more youth but the establishment and development phase of Pakistani SEZs is still continued so, Pakistani youth is facing the problems of less job opportunities.
- Both countries have certain security risks and Pakistan is leading than Bangladesh therefore, the level of FDI attraction is low in both countries but particularly in Pakistan it has deep impact on the FDI inflow.
- One-window services are not equally provided in every SEZ of both countries. Therefore, the connectivity issues lead to increase the concerns of the investors.

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Conclusion

This paper concludes that SEZs have played a significant role in promoting FDI in South Asia. In the contemporary times, SEZs are not only recognized as the engine of rapid economic development but also recognized as the driving tool of FDI inflow that helped to increase industrialization in any country that create more jobs for the locals and residents. Further, the spill over effects gave urge to more opportunities in the host country. However, Pakistan and Bangladesh both countries have faced many ups and downs in the FDI inflow even after the establishment of SEZs.

In the recent yesteryears, especially during and after COVID-19 era, Bangladesh’s SEZs performed relatively better than Pakistan. But it is also a fact that both countries have many challenges common in them. Those challenges should be resolved in effective manner to improve FDI inflow in both countries.

The study recommends that governments in both countries should focus on addressing the challenges faced by SEZs, including infrastructure constraints, bureaucratic hurdles, and security concerns. It also recommends that governments should consider to implement the policies to promote the development of SEZs, such as providing tax incentives and streamlining regulations. Finally, this study recommends that governments of both countries should focus on the promotion of the development of SEZs in strategic locations, such as near ports and transportation hubs to enhance their efficiency.

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