

# COVID-19 PANDEMIC IMPACT ON FREE ZONES

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**Abstract.** *The COVID-19 pandemic has an impact on global economic activity, but the negative effects vary from country to country. The key factors determining the depth of the impact are the economic situation at the beginning of 2020, the features of the economic structure and the fiscal capacity of governments to help citizens, businesses and the economy as a whole. Free zones and special economic zones are historically perceived as places that, to some extent, protect investors from unpredictability and act as places where the weak business environment is mitigated. The paper investigates the impact of the pandemic COVID-19 on the world's economic situation and free zones, as well as forecasts on the economic recovery for free zones. The objective of the paper – to analyse the impact of the pandemic COVID-19 on free zones' performance in the world and the global economic situation. The research study identified the impact of the pandemic COVID - 19 on the world's economic situation and the extent and nature of COVID- 19 pandemic impacts on performance in free zones, as well as the impact of the pandemic COVID 19 on the operation of free-zone enterprises in Latvia by analysing the example of Rezekne's special economic zone.*

*The descriptive methods, document analysis, comparative analysis was used in the study, as well as a survey.*

**Keywords:** free zones, special economic zones, COVID-19 pandemic, economic growth.

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## Introduction

The COVID-19 pandemic (coronavirus pandemic) is defined as illness caused by severe serious respiratory syndrome coronavirus 2 (SARS-CoV-2). It was reported to the World Health Organization on January 30, 2020, and on March 11, 2020 it was declared COVID- 19 is a global pandemic. The coronavirus COVID-19 pandemic is the greatest challenge we have faced since World War Two. The COVID19 pandemic has, with alarming speed, delivered a global economic shock of massive scale, leading to steep recessions in many countries.

As a result of the COVID-19 pandemic, global economic activity is expected to have fallen by nearly 10% in the first half of 2020 (WFZO, 2020). How quickly the world economy will recover depends on epidemiological developments and epidemic policy measures. Assuming that the development of the pandemic will lead to simplification of the containment policy and, thanks to monetary and fiscal policies, the outcome is expected to improve in the second half of this year.

Free zones and special economic zones are instruments of regional development to promote economic development that, to some extent, protect investors from unpredictability and act as places where the weak business environment is mitigated. The COVID-19 pandemic and its impact on the global FDI landscape is testing the resilience of SEZs. (UNCTDAT, 2020)

The paper investigates the impact of pandemic COVID - 19 on the world's economic situation, especially the influence of the COVID - 19 pandemic on development prospects and recovery of world free zones.

The objective of the paper – to analyse the impact of the COVID-19 pandemic on the world's free zone performance and the global economic situation.

Several tasks have been set within the framework of the study:

- 1) to describe the impact of the COVID - 19 pandemic on the world's economic situation;
- 2) to identify the extent and nature of COVID- 19 pandemic impacts on performance in free zones;
- 3) to identify the impact of the COVID 19 pandemic on the operation of free-zone enterprises in Latvia by analysing the example of Rezekne's special economic zone.

Free zones go by many different names, including special economic zones (SEZs), free trade zones, export processing zones and industrial parks. For the purpose of data analysis, this paper focuses on zones with a distinct regulatory regime and uses two concepts - a “free zone” and a “special economic zone”. Special economic zones go by many names and come in many varieties and sizes. They have in common that, within a defined perimeter, they provide a regulatory regime for businesses and investors distinct from what normally applies in the broader national or subnational economy where they are established. As SEZs emerged from the concept of free zones – free from tariffs, taxes and red tape – the basic components of an incentive package are very similar across most types of zones and most geographies (UNCTDAT, 2019). Despite the differences in terminology, free zones as well as special economic zones are generally implemented to reach fiscal, social and regional policy goals of the country and the most important fiscal goal of an SEZ is to facilitate economic growth through the use of reduced tariffs and more efficient customs control (Ezmale, Rimsane, 2014).

The descriptive methods, document analysis, comparative analysis was used in the study, as well as a survey.

## **Global impacts of the COVID- 19 pandemic**

The COVID-19 pandemic has, with alarming speed, delivered a global economic shock of enormous magnitude, leading to steep recessions in many countries. The baseline forecast envisions a 5.2 percent contraction in global GDP in 2020—the deepest global recession in eight decades, despite unprecedented support policies (World Bank, 2020). Several measures such as travel restrictions, closure of schools and non-essential business have been introduced by most countries to limit the spread of COVID-19. The pandemic and related mitigation measures have rapidly restricted consumption and investment, as well as curbed production. Global trade, financial and commodity markets, supply chains, tourism and travel were disrupted. The global recession would be deeper if control of the pandemic takes a longer time than expected, or if financial pressure causes cascading defaults. As a result of the COVID-19 pandemic, global economic activity is expected to have fallen by almost 10 percent in the first half of 2020 (WFZO, 2020) How rapidly the global economy will recover depends on the epidemiological developments and on how policymakers change their epidemic policy measures in response.

All regions in the world are expected to experience negative growth in 2020 (see Table 1). There are considerable differences across various economies, reflecting the development of the pandemic and the efficiency of mitigation strategies; as well as difference in economic structure and pre-crisis growth trends.

**Table 1. Overview of World Economic Outlook Projections  
(Percent change)**

Region	2018	2019	Projections	
			2020	2021
World output	3,6	2,9	-4,9	5,4
Advanced Economies	3,6	2,9	-8,0	4,8
Emerging Market and Developing Economies	4,5	3,7	-3,0	5,9

Source: IMF, 2020

On the positive side, the recovery is benefitting from special support policy, mainly in advanced economies, as well as in less developed economies and emerging markets. Global fiscal support now stands at over 10 trillion USD dollars and monetary policy has eased dramatically through interest rate cuts, liquidity injections, and asset purchases. In many countries, these measures have succeeded in supporting livelihoods and prevented large-

scale bankruptcies, thus helping to reduce lasting scars and aiding a recovery (Gopinath, 2020).

It was concluded that one of the factors that will affect the severity of the crisis and the time needed for recovery is the health of the economy at the end of 2019 and its potential resilience to shocks. According the World Economic Outlook data (IMF, 2020) about COVID-19 pandemic impacts on various national economies, countries with weaker performance in the final quarter of 2019 are among the countries with the largest drop in the first quarter of 2020.

The countries in which economic growth was driven by sectors that stopped or only partially performed their activities as a result of COVID-19 restrictive measures (e.g. tourism, catering, etc.) are at greater risk. On the one hand, many companies were unable to continue their business, leading to a sharp decline in the supply of services and products in the economy. On the other hand, restrictive measures directly affected demand. As people stayed at home, their spending on trips, supermarkets, restaurants and entertainment declined. The rapid recovery in demand will be determined by factors such as population welfare (average household income and social security), the gap between lower and higher incomes. The ability to make savings will determine the depth of GDP decline and the time needed to return the economy to a “pre-virus” state.

### **Impacts of the COVID-19 pandemic on free zones in the world**

Over the last two decades, in particular, special economic zones have proliferated in emerging and transition economies. States promoting zones have sought to stimulate economic development both within and outside the zone. Within the zone, states aim to attract investment that will lead to new firms and jobs, and to facilitate skills and technology transfers. Outside the zone, states aim to generate synergies, networks, and knowledge spillovers to foster additional economic activity. (World Bank, 2017) Free zones are generally implemented to reach fiscal, social and regional policy goals of the country, and the most important fiscal goal of a free zone is to facilitate economic growth through the use of reduced tariffs and more efficient customs control. (Ezmaie, Rimsane, 2014) The creation of free zones can increase investment in supporting infrastructure, such as transport, electricity, water and sewerage, gas pipelines, not only within the zones but also in surrounding areas.

In the World Investment Report 2019 it is concluded that special economic zones are used by more than 140 economies around the world, almost three quarters of developing economies and almost all transition economies. Their number has grown rapidly in recent years, and at least 500

more are in the pipeline. Special economic zones are an important instrument of industrial policy because of the opportunity they can provide for technology and skills development. Linkages with local firms, spillovers, crowding in and demonstration effects are key to maximizing the industrial development impact of SEZs. One of the key rationales for SEZs development is to generate employment. Zones are generally considered an effective tool for job generation. Worldwide, an estimated 90–100 million people are directly employed in special economic zones and free zone programmes (UNCTDAT, 2019). A significant share of global trade is created by free zones around the world (Gern, Möhle, 2020). Special economic zones have become an increasingly widespread instrument to encourage economic development of countries.

The COVID-19 pandemic and its impact on the global FDI landscape is testing the resilience of SEZs. A recent survey among SEZs revealed that the majority have been significantly affected, as many operate in sectors and activities where working from home is not an option. In addition, they have been affected by global supply chains disruptions, decreased global demand and a deterioration of global financial conditions. (UNCTDAT, 2020) In a regional perspective, the share of free zones reporting a significant loss of business due to the drop in global demand is particularly high in Asia and Latin America. Production problems due to supply chain disruptions are relatively more prominent in Asia and Africa and the Middle East, whereas a deterioration in the financial environment seems to be relatively most important as a transmission channel in Latin America (Gern, Möhle, 2020).

The World Free Zones Organization, in collaboration with the Kiel Institute of the World Economy, started the Free Zones World Economic barometer (F-WEB) in 2018. The F-WEB is a quarterly, survey-based sentiment indicator designed to gauge current momentum and future trends of economic activity in free zones and special economic zones around the globe. (WFZO, 2020). The F-WEB second quarter (Q2) survey was conducted between May 18 and June 5, 2020 in order to find out to what extent and by which channels the COVID- 19 pandemic disturbs economic performance in free zones. Representatives of 86 free zones in 48 countries worldwide participated in the survey.

The F-WEB survey consists of a set of questions related to economic performance in free zones that are asked every quarter in order to establish a history of results that can be used to extract information about economic developments over time. In addition, a small number of special questions are included in every round that will be asked at a lower frequency or irregularly as a response to specific developments. In the F-Web Q2 survey, there was a special section with questions about the impact of the COVID-19 pandemic on the economic situation in free zones. The questions are qualitative in

nature and can be answered by choosing positive answers (increasing, improving, good), negative answers (decreasing, deteriorating, poor) or neutral answers (unchanged, more or less the same, normal) from dropdown menus (WFZO, 2020).

The share of free zones participated in the survey with 1- 99 employees was 29 percent, 100 to 999 employees was 46 percent, 1,000 to 9,999 employees was 13 percent and over 10,000 employees was 12 percent.

The main conclusions of the Report 2020 are following:

1. Amid the COVID-19 pandemic, the percentage of free zones evaluating their current economic situation as good plunged from 56 percent in the first quarter of 2020 to 15 percent in the second quarter. At the same time, the share of free zones reporting poor conditions jumped from 7 percent in the previous quarter to 36 percent now.
2. More than half of all free zones had a decrease in turnover, investment, and profitability compared with the previous three months. In addition, more than 45 percent of free zones saw a decrease in employment.
3. Almost two-thirds of free zones assess their overall economic situation as worse than in their host country in general, indicating that they are disproportionately affected by the COVID-19 pandemic.
4. While at the start of the year two out of three free zones had been positive about the next three months, now less than half of the respondents (43 percent) expect an improvement of economic conditions in the near future. One in three free zones expect the economic situation to remain stable and one in four free zones have a pessimistic outlook.
5. Over 90 percent of free zones state that economic activity is currently hampered by the spread of COVID-19. While 62 percent of free zones report some limitations, over one in three respondents report the impact of the pandemic to be substantial. Only 5 percent of the respondents indicate that their free zone is currently not really affected.
6. Less than half of the respondents (43 percent) expect an improved economic situation in the near future. One in three free zones expect the economic situation to remain stable and one in four free zones have a more pessimistic outlook (WFZO, 2020).

Free zones are affected by the pandemic through various channels. First, economic activity in many countries has come to a halt due to measures taken by governments to contain the spread of the virus. These measures also affect free zones, especially since they are often engaged in sectors and activities where working from home is not an option. Second, health measures and high levels of uncertainty regarding the future development of the pandemic drag on consumption and investment. Recent estimates of UNCTAD (2020) based on earnings revisions of the largest multinational

enterprises suggest that FDI could drop by as much as 30 to 40 percent on a global basis during 2020-2021. Third, production in free zones could be affected by supply chain disruption (Gern, Möhle, 2020).

In many countries, SEZs are supporting the role of Investment Promotion Agencies (IPAs) in not only keeping investors abreast of COVID-related policy measures targeted at businesses, but also in investment facilitation and aftercare services to help existing investors continue to operate during these challenging times. Together with IPAs, SEZs – particularly those that focus on health and bio-tech sectors – have had an important role in contributing to national efforts to source equipment and materials in support of combatting the pandemic. As SEZs are increasingly oriented towards fostering innovation and promoting high-value activities, including in digital sectors, they may be catalysers for innovative solutions to the new challenges of a post-pandemic economy UNCTAD (2020).

Almost all free zones worldwide are already affected by the pandemic at least to some extent, and the free zones expect limitations to activity to become worse in the coming months. While free zones in all world regions are affected, expectations are most pessimistic in Asia, followed by Latin America (Gern, Möhle, 2020).

It could be concluded that nearly all free zones in the world have been affected by the pandemic, and they expect that activity restrictions to get worse in the end of 2020. The pandemic affects free zones in different ways. First, economic activity has delayed in many countries, as governments have taken steps to control the spread of the virus. These measures also affect free zones, as there are businesses operating in sectors where work at home is not possible. Secondly, health measures and a high level of uncertainty regarding the future development of the pandemic have an impact on consumption and investment. Consequently, foreign direct investments could be reduced worldwide also in free zones. Thirdly, production in free zones could be affected by supply chain disruptions.

### **Impacts of the COVID-19 pandemic on the enterprises of the Rezekne Special Economic Zone in Latvia**

The current economic prognosis from the Ministry of Finance show that Latvia will experience a fall of gross domestic product in 2020 by approximately 7%. Additionally, it is seen that due the coronavirus crisis the unemployment rate will have increased by 4.9% in comparison with 2019, reaching 11.2% in 2020. The data from the Ministry of Finance shows that during the year 2020, the total import will have decreased by 10.0% in comparison with 2019, and the total export level will have fallen by 9.0%. A significant decrease in investment is forecasted for 2020. Although

investment flow will be strengthened by the increase in public investment set out by government decisions, high uncertainty will deter new private investment income (Linde, 2020).

The Rezekne Special Economic Zone (Rezekne SEZ) is a territorial regime type manufacture and trade-based free zone with a total area of 1155 ha and 20 resident companies at the beginning of 2020.

The survey of Rezekne Special Economic Zone enterprises was conducted between August 1 and September 18, 2020. Representatives of 19 enterprises or 95 percent of the total number of Rezeknes SEZ enterprises participated in the survey. The share of small sized enterprises with 1 to 49 employees was 68.4 percent, the share of medium sized enterprises with 40 to 249 employees was 21.1 percent, the share of large sized enterprises with more than 250 employees was 10.5 percent. This corresponds to the distribution of small, medium and large sized enterprises in Rēzekne SEZ. The survey consists of a set of questions related to the impact of the COVID-19 pandemic on the economic performance of Rezekne SEZ enterprises. The questions are qualitative in nature and can be answered by choosing positive, negative or neutral answers.

According to the results of the survey, 5.9 percent of Rezekne SEZ enterprises evaluated the overall economic situation as good, 47.1 percent as normal and 58.8 percent as poor. The vast majority of Rezekne SEZ enterprises was currently affected by the pandemic - 76.5 percent of the enterprises reported a decrease in turnover due to the COVID-19 pandemic, while 17.6 percent of enterprises stated that turnover increased, and only 5 percent of the respondents indicated that their turnover currently was not really affected. The situation was slightly different in terms of the number of employees- 23.5 respondents increased their numbers of employees, only 11.8 percent decreased, but the vast majority (70.6 percent) of the enterprises kept their numbers of employees unchanged. Only 23.5 percent of the respondents have used the instruments offered by the state to mitigate and prevent the effects of the COVID- 19 pandemic.

Less than half of the respondents (35.3 percent) expected an improvement of economic conditions in the near future. One in two enterprises (47.1 percent) expected the economic situation to remain stable, but 29.4 percent of the enterprises had a pessimistic outlook. The deterioration in expectations is reflected in expected turnover. One of three of the respondents (35.3 percent) expected a decrease of turnover and 35.3 percent of the respondents expected an increase over the next three months, but 41.2 percent of the respondents believed that it would not change. More optimistic Rezekne SEZ enterprises were on employment figures in the next 3 months. The vast majority of Rezekne SEZ enterprises (82.4) expected that

the numbers of employees would remain unchanged in the next 3 months, and only 5.9 percent planned to reduce the numbers of employees.

### **Conclusions and suggestions**

All regions in the world are expected to experience negative growth in 2020. Latvia will experience a fall of gross domestic product in 2020 by approximately 7%. Also, nearly all free zones in the world have been affected by the pandemic in different ways, and they expect that activity restrictions to get worse at the end of 2020. Furthermore, most of the free zones expected economic activity to remain affected for the next few months, despite the initiatives taken to stimulate business and support their tenants.

Amid the COVID-19 pandemic, it could be concluded that Rezekne SEZ enterprises are more negative about the current economic situation and about economic conditions in free zones globally in the near future. According the World Free Zones organisation survey (WFZO, 2020), 15 percent of free zones worldwide evaluated the economic situation as good and 49 percent as normal in the second quarter. While 43 percent of the free zones expect an improved economic situation in the near future. One in three free zones expected the economic situation to remain stable and one in four free zones had a more pessimistic outlook. For comparison, 5.9 percent of Rezekne SEZ enterprises evaluated the overall economic situation as good, 47.1 percent as normal and 58.8 percent as poor. Additionally, only 35.3 percent of the Rezekne SEZ enterprises expected an improvement of economic conditions in the near future, 47.1 percent expected the economic situation to remain stable, but 29.4 percent had a pessimistic outlook.

As a response to the global COVID-19 pandemic, free zones will need to reconsider their value proposition and strategic focus. Changes in the FDI environment, as well as a new industrial policy that will result from the pandemic, will require closer cooperation between free zones and investment promotion agencies. In this context, free zones should work closely with investment promotion agencies to set strategic targets in line with new national investment priorities.

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