

# **Special Economic Zones (SEZs) and Prospects for the Domestic Economy of Pakistan**

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# Introduction

- CPEC---\$62 billion Memorandum of Understanding (MoU) between China and Pakistan—Infrastructure, Energy, Gawadar, Special Economic Zones (SEZs)
- Game Changer—Trade, Market Access, Regional Connectivity, Infrastructure Development.
  - Industrialization, Business Parks, Industrial Estates, SEZs etc.---Higher Investment, Employment Generation, Exports and Growth
- Coordination Problem---Routes, Allocation of Economic Zones, and Infrastructure Development.
- Successful SEZs Model
  - SEZs in China-1750 SEZs---Contributing 22% to national GDP, 46% to FDI, and 60% to exports
  - Necessary Conditions for Success—Good Governance, Controlling Rent-Seeking, Soft Regulation and Competitive Private Sector.
- In this study, We want to discuss SEZs in Pakistan in order to:
  - Analyze the Importance of SEZs under the CPEC for Pakistan
  - Discuss the threshold conditions for successful SEZs
  - Give some policy Options regarding the facilities at SEZs by taking into account the history of Pakistan’s industrial structure.

# Clustering of Industries in Pakistan: Background

- **Background of Industrial Sector in Pakistan**
  - Import Substitution and Export Promotion in 1960s—Differentiated Tariffs, Import Rationing, Over-valued Exchange Rates, credit at subsidized rates etc—Higher manufacturing growth but the creation of **Schematized Interest Group**
  - Nationalization in 1970s—Declining Manufacturing growth—Inefficiency and Sick Industrial Units etc.—Dichotomous Performance onwards
- **Industrial Estates**—Pakistan established around 100 Industrial Estates—the industrial failure in 1970s.
- **Industrial Clusters**—We have some successful clusters
  - Sialkot Surgical Goods Cluster;
  - Gujarat Ceramic/pottery Industrial cluster;
  - Faisalabad Readymade Garments Manufacturing cluster;
  - Khyber Pakhtun Khwa (KPK) Marble Cluster;
  - Tannery/Leather Industrial Cluster and
  - Gujranwala cluster etc.
- **Special Economic Zone (SEZ)**—is a specific area of the land used to promote industrial growth in a country by providing more lenient economic and tax policies as compared to general economic policies in a country.
  - Offer immediate access to high-quality infrastructure, uninterruptible power supply, clearly titled land, public facilities, and other support services.
  - Governed by streamlined regulatory framework, simpler business and establishment rules, expedited customs administration, and other special administrative and approval procedures are also offered in such zones.
  - 43,00 zones in 135 countries today—accounting for over 68 million direct jobs and over \$500 billion of direct trade-related value added within zones."

# SEZs: Expected and Current Status in Pakistan

- **Expected SEZs in Pakistan**

- 40 SEZs are expected to setup across country under CPEC by introducing Gwadar SEZ as first model based on area of 3000 acres on special discretion of China---28 are identified so far---8 SEZs in Khyber Pakhtunkhwa--7 in Punjab and Baluchistan each---3 in Sindh while Gilgit-Baltistan and Islamabad and AJK will have one, each.

- **Current Status**

- Since the SEZ Act in 2012-Promotion of six industrial estates such as
  - Multan Industrial Estate Phase-II, Bhawal Industrial Estate
  - Mianwali, and Rahim Yar Industrial Estates,
  - Dera Ghazi Khan and Rawalpindi Industrial Estates,
  - These under CPEC project have expectation of 1.5 million jobs creation.
- Board of Investment (BOI), Pakistan approved additional three SEZs in Punjab such as:
  - Quaid-e-Azam Apparel Park (QAAP) at M2 near Shaikupura Interchange,
  - Industrial City located on Trade corridor and M3 near Sahiwal interchange
  - 225 acres Value addition City near Faisalabad on Expressway.
  - Turnover of Rs. 1 trillion is expected with creation of 2 million jobs through these SEZs
- Below is the list of currently approved SEZs and 7 of them are in progress
  - ICT Model Industrial Zone, Islamabad, Federal
  - Mohmand Marble City, FATA
  - Rashakai Economic Zone (REZ), KP
  - China Special Economic Zone Dhabeji, Thatta, Sindh
  - Mirpur Special Economic Zone, AJK
  - Bostan Special Economic Zone, Baluchistan
  - Steel Mills at Port Qasim Special Economic Zone, Federal
  - Moqpondass SEZ Gilgit-Baltistan

# Expected Facilities Offered in SEZs under CPEC

- **Fiscal Incentives**

- One time exemption from all customs duties & taxes for all capital goods imported for the development, operation and maintenance of an SEZ
- Exemption from all taxes on income accruable in relation to the development and operation of the SEZ for a period of five years.
- One-window facility within the SEZs by BOI—Dry port facility etc.

- **General Incentives**

- Provision of Gas, Electricity and other utilities at the zero-point of the Zones—Permissible Captive Power Generations
- Continuity of Incentives—Cannot be withdrawn midway—Cannot be modified to the disadvantage of an enterprise.
- Transparent procedures for establishment of SEZs—best practices for building codes, environmental protection and workforce—Security arrangements by the respective provincial government—efficient dispute settlement mechanism

- **Facilities in Gawadar EPZ**

- Tax Facilities

- Tax Exemption for 23 years effective 01 July 2016 on profits and gains from business set up in the Gwadar Free Zone Area.
- Tax exemption for 23 years effective 06 February 2007 for specified Chinese companies working on the Gwadar port.
- Tax exemption for 20 years effective 01 July 2016 for contractors and Sub-contractors of specified Chinese companies working at the Gwadar Port.
- Other facilities in terms of Sales tax, withholding tax and Excise duties are provided to both Chinese and Local investors.

- Similar facilities all industrial estates and EPZs which are related to CPEC

# SEZs: Prospects for the Domestic Economy

- **Static Effects**

- Industrialization, Employment Generation—Firms in SEZs have linkages to the domestic market, so that their investors buy production factors from domestic sources—Incentives Effect
- Higher FDI and Exports—Incentives Effect
- Cluster development, or Agglomeration of certain Industries

- **Dynamic Effects**

- Infrastructure
- Joint Ventures—the interaction of foreign firms with domestic firms
- Technological Upgradation—the spread of knowledge from foreign corporations to domestic business
- Human Resources Development—competitive environment leads to skill development
- Urban Development
- Competitive Private Sector

- **Experimental Effects—SEZs as Processes**

- Comparison of Alternative Policy Options as SEZs may Serve as a treatment group
- Economic Reforms—In the context of political decentralization, SEZs can encourage competition between regions for capital, spurring reforms on the local level—more political autonomy within SEZs, more faster reforms within SEZs than the rest of the country

# SEZs: Threshold Conditions for Success

- **Ideal World**—Omniscient and Benevolent Policy Makers
  - The relaxation of the assumption of Perfect Knowledge and Benevolence implies Successful SEZs require right institutional Context—the Hayek World
- **The Knowledge Problem**—when decision making is trusted to policy makers who are too far away from market to adequately understand it.
  - Centralized Decision Making—Officials cannot study the fluctuations in economies—SEZs tend to be badly designed and misplaced
  - Private Decision Making—Businesses are well-informed about the mechanism of market—better zones locations, better enterprises, efficient organizational structure.
  - Decentralized Decision Making
- **The Incentive Problem**—arises when the incentives of the policy makers are not aligned to the incentives of successful SEZs or overall economic welfare.
  - SEZs create Opportunities for Rent-seeking—Policy Makers are no more benevolent—Again, we need the World of Hayek
  - Private SEZs—Align incentives of private developers—Fewer Opportunities for Rent-seeking and Corruption to officials

# SEZs: Threshold Conditions for Success Cont.

- **Labor Policy**
  - Employment of Local Workers---In this regard, China has labor relations with other countries like Egypt Mauritius and Nigeria etc. Pakistan should come up with clear labor policy.
  - Second, we should have clear policy guidelines with regard to the protection of workers rights—with respect to union memberships, working conditions and safety measures etc.
- **Controlling Internal Rent-Seeking of Industrialists**
  - All the incentives given should be tied clearly with the efficiency perspectives--- bad experience of 1960s and other industrial estates in Pakistan.
  - Problem with subsidies—hard to remove, interest groups, rent-seeking
- **Solving Coordination Problem**
  - First, there was coordination problem over the allocation of routes—four routes have been defined. Second—the budgetary allocation for the completion of routes should be balanced based on the productivities of all possible routes.
  - Third, the distribution of projects should be based on both the need and efficiency perspectives.
- **Internal and External Security**
  - Good Relations with Neighbours
  - Peace in Afghanistan and FATA
- **Micro Foundation of our Potential Exports and Imports**
  - Afghanistan and CARs could be potential market for Fruits, Meat, Vegetables, fertilizers, textiles products and other grossary products—Imports of Cheap Energy from CARs