SPECIAL ECONOMIC ZONES (SEZS) A COMPARATIVE ANALYSIS FOR CPEC SEZS IN PAKISTAN

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Abstract- Special economic zones (SEZs) around the world are normally established with the aim of achieving various policy objectives: to attract foreign direct investment (FDI), to generate employment, and to be experimental with economic reforms via zone-exclusive trade policies. Pakistan has already signed Memorandums of Understanding (MOUs) for an upward of nine SEZs throughout the country in collaboration with China under the China-Pakistan Economic Corridor (CPEC) program. The purpose of this study is the assessment of socio-economic impacts of various SEZs in diverse regions via comparative analysis. We especially focused on those SEZs that are similar to Pakistan in regard to the economic profiles of the respective states. Moreover, we particularly observed the literature on FDI phenomenon in this perspective to assess the extent to which the SEZs have helped improve the socio-economic outcomes in the vicinity of the local communities surrounding such zones and hence, brought about broad-based economic development there. In the present study, SEZs that have proved to be poor in regard to export volume, ameliorating of the domestic labour force’s technical skills and overall inefficiency (such as those in Africa) are stacked up against those that have performed with high levels of productivity and viable economic gains such as those found within China, Bangladesh, and the ASEAN member states in order to decipher the common features of SEZs that enable them to be more effective in the long-term. Our analysis indicate that overall, African SEZs have not led to significant job creation or poverty reduction because of failures in implementing proper regulations. However, Asian SEZs on the other hand, have shown many socio-economic benefits. We thus concluded that we can co-opt African experiences with SEZs in order to improve the Asian framework for the same zone-type setup as Pakistan. This will certainly help us out to attain maximum socioeconomic benefits from its own CPEC-oriented SEZs and hence, allow for the development of a basic framework that Pakistani SEZs should adhere in order to avoid the meagre gains seen in failed zones such as those in Africa.

JEL Classification: F16, G18, H54
Key Words - Special Economic Zones (SEZ), Asian SEZ, FDI, Exports, Employment
I. INTRODUCTION

A mutually acceptable mechanism among the researchers to accumulate and sustain the growth of GDP and to revolutionize the status of developing towards developed, is to expand exports by encouraging industrialization to facilitate FDI for export oriented production. To keep this into account, numerous government policies have adequately concentrated in encouraging exports as a tool to improve the productivity and advancement of the overall economy. Among these policies the most considerable strategy which has been widely practiced by a number of countries, is to establish special economic zone (SEZ). As per the Ministry of Commerce SEZ is defined as “A specifically duty free enclave which shall be deemed to be foreign territory for the purpose of trade operations and duties and tariffs”. The SEZ is further categorized into several specific zone types, which include Free Ports, Industrial Estates (IE), Export Processing Zones (EPZ) and Free Trade Zone (FTZ).

As discussed earlier that, the rendering of Special Economic Zones (SEZs) in many developing states is meant to encourage intensive foreign direct investment (FDI) into particular pockets and clusters of state’s industry. This in return stimulates the local, government to subsidize various facilities like assuring the provision of uninterrupted electricity, favourable trade and tariff legislation which are only applicable to those goods tendered and produced within SEZs. Similarly, indigenously-provided labour and viable transportation networks for the exports of the production are some of the most appealing tasks and benefits of SEZs. Such zones are meant to complement existing commercial activity within a particular region to increase diversification, render the possibility of value-added commodities, boost employment, and encourage improvements in labour standards by keeping it in line with internationally-set standards as per the origin of the FDI meant for SEZ. Pakistan has already signed Memorandums of Understanding (MOUs) for an upward of nine SEZs throughout the country’s different provinces in collaboration with China under the China-Pakistan Economic Corridor (CPEC) program, which further falls under One Belt One Road initiative (OBOR). The flagship component of CPEC funding is the Gwadar port project, which aims to cut shipping times for Chinese commodities drastically via bypassing the Strait of Malacca, which in turn saves almost 10,000 miles worth of ocean routes (FIGURE 1.3) for Chinese shipment tankers. Therefore, the Gwadar port project proves to be one of the most crucial vicinity for the future of Pakistan as compared to any other port with respect to energy, transport, and security. However, there exist some profound examples which highlights the core issues potentially prevailing within the time period of installation and functioning of SEZs, especially, in developing countries. These zones do create some long-term impact like environmental pollution, exploiting the profitability and creditability of other operating firms outside of these zones, producing negative externalities etc. Keeping in view these challenges, adequate steps like human rights and Corporate Social Responsibilities (CSR) should be integrated in every step of establishing SEZ.

In a nutshell, SEZs are a subset within the geographical boundaries of the state needed to expand exports, develop infra-structure, increase employment and minimize the distortions usually faced from the administration along with low or no tax. On these foundations, this particular study aims to assess the exact potential of Pakistani SEZs via a detailed insight especially encompassing the challenges faced by the SEZs operating in many parts of the developing world, namely Africa and Southeast Asia, in order to avoid such incidences in establishing SEZs in Pakistan.
II. LITERATURE REVIEW AND THEORETICAL JUSTIFICATION

Geographically encircled fenced-in territories, popularly referred to as SEZs, have flourished all over the world. Areas free from the regulations and policies applied elsewhere have also been named as the ‘foreign territories’. Almost every aspect of the debate on SEZs have shared the impression of ‘successes’. As the present study strives to analyse the potential benefits and fruits which are attainable for Pakistan. However it is only possible after considering certain restrictions and cautions. There exists a number of cases where such projects/constructions have assisted not more than wasting lands and bringing a common man towards hardships and starvation. On the other hand, by taking into account the reasons of breakdowns and adopting the sense of responsibility through taking certain steps can bloom and yield innumerable gains.

Pro and Cons of SEZs

Analysing the SEZs functioning in India, Gopalakrishnan (2007), indicated certain complications and negative impacts of SEZs in India by analysing the history of SEZs in China. The study highlighted the negative effect of SEZs by emphasizing of insulation of rest of the areas from this zones and indulging the SEZs in particular, resulting in threatening and shutdown of local industries, hence, hampering the exports and foreign reserves. Secondly, the problem of speculation and land loss phenomenon was argued by Cartier (2002) and, Hang and Yong (1996), who provided evidences on the grants and acquisition of hectares of lands, however, developing only half of it, while wasting the other half. O’Bien and Leichenko (2000) argued a prominent adverse effect of such economic zones, particularly referred to as ‘climate change’, which indicates advantages of opportunities for certain regions or social groups, while leaving the others to absorb the adverse effects or the negative externalities produced by SEZs. Similarly, Marrakech (2009) and, Farole and Akinici (2011), added a very crucial point that, in the past, SEZs operating and established by the public sectors failed to meet the objectives of SEZs, consequently, several countries revised the regulations in allowing the government to involve in such projects. Currently, 62 percent of the SEZs are either solely managed by the private sectors or are jointly managed by the governments and the private sector.

On the other hand, a list for the benefits and incentives of SEZs can be provided which have been analysed, predicted and practically implemented in a bulk of studies. As SEZs are established to attract FDI, therefore the very first benefit is in terms of the investment from the foreign countries which enhances the GDP growth of the country, hence, generates employment, expands infrastructure and transforms traditional economy towards technological development as documented by Johannesburg et al. (2012), Monga (2011), Pakdeenurit and Suthikarnnarunai (2014) and The World Bank (2012).

Orthodox and Heterodox Analysis

The orthodox approach focuses on the static economic outcomes of SEZs. These static economic welfare comprises the generation of direct employment, FDI inflows, economic value-addition and foreign exchange earnings. Hamada (1947) is considered as one of the most pioneer study conducted on SEZs in this regard. The study analysed direct short-term effects of SEZs in the respected localities. This approach is also considered as the second best option after full trade liberalization and full-fledged market reforms. The studies encompassing this phenomenon includes, Aggarwal (2010), Baissac (2011), Farole and Akinici (2011) etc.

The heterodox approach, on the other hand focuses on the dynamic effects. This became a prominent approach in late 1980s. In particular, it is based on the endogenous growth theory which intensifies
sustainable growth of the overall economy, by covering the development in human resources, technology, and institutional reforms. These studies include Milberg and Amengual (2008), Agarwal (2010) and Baissac (2011).

Keeping in view the above discussion, the establishment and operation of SEZs should be subject to certain restricted policies in order to attain maximum potentials for the prosperity and development of Pakistan. In the next section, we shall critically analyse the benefits and incentives as well as the issues keeping into account the static and dynamic economic outcomes experienced by the SEZs operating in countries categorized into same development level as Pakistan.

III. METHODOLOGY

In assessing the performance of SEZs, we define two types of outcomes under a broad concept, socioeconomics:

a. Static economic outcomes of SEZs. Encompassing the direct effect of these projects which includes the volume of investment, exports and the employment generated.

b. Dynamic economic outcomes of SEZs. This includes a relatively long-term impact of the investment in terms of technological improvements, human resource development and overall surge in the living standards of that particular vicinity.

In our methodology we will be focusing on analysing the above stated outcomes through the assessment of SEZs by comparison. We have picked the case of SEZs that is similar to the development level of Pakistan. Then we will observe the analysis carried out to assess the extent to which the SEZs has helped to improve the socio economic outcomes in the relevant localities and thus brought about broad-based economic development there. In this regard, we have used secondary data acquired from already set up SEZs in different regions to analyse the socio economic situations. With the help of this data we will draw out important implications for Pakistan. Because, low to middle-income countries seeking to implement a development model are more often turned towards the experiences faced by the Asian countries in executing similar models. The countries representing Asia’s SEZs include Bangladesh, Cambodia, Philippines, and India. On the other hand, African SEZs have also been analysed for the socio economic situations prevailing there. This paper aims to identify and examine that how the SEZs can contribute with maximum potential in terms of job creation, sustainable GDP growth by improving the volume of exports and foreign direct investment in case of Pakistan.

Pakistani Special Economic Zones (Sezs)

An upward of nine total SEZs have been approved far under the auspices of the CPEC infrastructural and energy corridor. These SEZs will utilize specifically designed favourable tariff and tax legislations which will allow an expansion to Pakistan’s manufacturing output alongside the CPEC motorways aiding in delivering the final products from this platform. These various zones as proposed in conjunction between the Pakistani and Chinese federal governments are located in Nowshera (KPK), Dhaveji (Sindh), Bostan (Balochistan), Faisalabad (Punjab) Islamabad (Federal), Port Qasim near Karachi (Federal), Mirpur (AJK), Mohmand (FATA) and Monqbonass (Gilgit/Baltistan). The exact locations and industrial cluster niches can be seen in FIGURE 1.1.

Pakistan has experienced the implementation of SEZs in the past, but none at the scale and metrics that CPEC-oriented ones are set to deliver. The Special Economic Zones act was passed by Pakistan's Majlis-e-Shoora (Parliament) in September of 2012, allowing for various incentives in regard to machinery import taxation, in order to establish a framework for combined public-private ownership of ventures within the private sector itself.¹¹ Such ventures can be conducted on either a state-to-state basis
SEZs have attracted significant levels of foreign investment into Cambodia that would not have been present otherwise. Currently, 9 SEZs are operating while 20 more are authorized to begin operation. These projects have created around 68,000 total jobs raising the economic welfare of domestic labour.\textsuperscript{iv} However, due to small size of SEZs, it employs only 1 percent of total and 3.7 percent of the manufacturing sector employment of Cambodia. One thing which is pertinent to note here is that the garment industry dominates the manufacturing sector of Cambodia employing 600,000 labours. TABLE 1.1 reveals the massive uptick in general employment generated by Cambodian SEZs.

The main objective of SEZs was to diversify in terms of manufacturing products. Therefore, the SEZs are more diversified, producing electronic products and home appliances. Such kind of production certainly employs technical labours which help to improve and to develop human resource. But unfortunately, the top brass is hired from abroad to operate the industry, while low skilled labours are employed from within Cambodia as non-technical operators. It has also been examined that the firms operating in SEZs invest less in trainings of non-technical labour, as 30\% of new labour are those who never attended schools, hence, require long-term adjustment programs.

Secondly, in terms of the expansion of exports, the net effect in case of Cambodia has been neutral. These industries tend to purchase intermediate goods from abroad and do not produce for domestic markets, which somehow balances the equation. The only benefit of SEZs in Cambodia is in terms of local taxes if applied, employment but with low-skilled operators, purchase of land, electricity, water, etc. A salient feature of the Cambodian SEZs is that the government has left the establishment and management of the zones to private sector developers, avoiding large and sometimes wasteful public sector set up costs associated with SEZ establishment in many other countries.\textsuperscript{v}

The overall circumstances prevailing in Cambodian SEZs are somehow satisfactory but the ambition to achieve maximum potential from these firms is to improve the literacy rate of new employees to motivate the SEZs firm to invest in further trainings of the labours. Secondly, the domestic industries should focus on the production of intermediate goods to attract SEZs towards them. In this manner, the exports of the country can increase hence both static and dynamic economic outcomes can be attained.

Bangladesh SEZs

The case of Bangladesh highlights the importance of locating the zone program appropriately in producing those products in which it has comparative advantage. Although the SEZ program in Bangladesh primarily focused to attract high-technology investment, but it only took off when concerted efforts were made to focus on the garments sector, in which it had relatively comparative advantage. TABLE 1.2 displays the advantages, the apparel and garment industry enjoy in Bangladesh in regard to financing against other industries. The percentage share of FDI flow in the EPZs of Bangladesh has highly recorded at 81\%. The incubation period for SEZs operating in Bangladesh before they initiated to build momentum spanned 5 to 10 years. Same was the case for even the most successful SEZ like those operating in China and Malaysia which started slowly and took at least 5 to 10 years to operate on
maximum. Therefore, in Bangladesh, the SEZ program started in early 1980s, but it managed to attract investment on a large scale in early 1990s. From a policy perspective, this analysis provides the governments the information to be patient and to provide consistent support to zone programs over long time periods. This seems to be an immense challenge in countries with shorter political cycle. Another noteworthy revolutionary transition of Bangladesh economy has been observed. As whole nation economy is seeking to transform itself into EPZ, consequently the relevance of EPZ in Bangladesh will gradually diminish, as far as the trade policy prospective of the country is concerned.

Millions of work force is entering in the economy annually. On the other hand, the contribution of the EPZs to employment generation is crucial. As of 2009, about 220,000 jobs had been created in the EPZs. More than 99 percent of the total labours are of local community providing direct jobs to the workers of Bangladesh. The employment growth rate is impressively increasing annually by almost 32 percent. There are three types of EPZs prevailing in Bangladesh, first, the industries fully owned by foreign, second, those owned solely by domestic individuals and third comprises joint ventures between local and foreign individuals. 86 percent of the workers are employed in fully foreign owned industries while 9 percent in domestic industries and only 8 percent in joint ventures which clearly presents the contribution of foreign based industries in the labour market of Bangladesh.

Moreover, the contribution of EPZs in the expansion of exports has been significant. The exports of the country have been double on average against the imports, conclusively strengthening the overall performance of the economy. In South Asia, zones in Bangladesh have been contributing 75 percent of the national exports.

**Philippines SEZs**

The Philippine Economic Zone Authority (PEZA) was created by the Filipino government under the Special Economic Zone Act 1995, which provided a great opportunity for the foreign investors to concentrate on investing in garments, shoes and toys. As of April 2007, 336 SEZs have been documented across Philippines. As the main task of the SEZs is to attract as much foreign investments as possible, therefore, more than half of the total FDI inflows of Philippines are constituted by the PEZA. The highest peak of the FDI inflows have been recorded in 2012 and documented 6.9 US$ Billion out of which 5 US$ Billion were specified for the SEZs.

Massive inflows of FDI towards the labour-intensive activities have pushed up the employment rate of Philippines. Over 3 million jobs have been created under these projects which certainly enhanced the living standards of a million more. The most successful region which lead to such extensive investments along with job creation is the Region 4, located in the south of Metro Manila. It comprised 69 of 200 SEZs across the country, employing 2 million of jobs from 3 million of all the SEZs combined. But, on the other hand, the unemployment rate at the same region up surged drastically from 8 percent to 13 percent within a time span of only 10 years. An increase in the migrants has been accused as the main factor for this incidence. Therefore, a better planning with deep insights should be under consideration in planning and specifying the areas for SEZs.

The government of Philippines committed to diversify the manufacturing products from the traditional minerals and agricultural commodities. In this association, TI ensured to build electronic plants which attracted other prominent firms to focus on the true potential of Philippine. These firms set up co-operative training programmes to upgrade the semi-skilled labour from the above-average educational resources in the area. Altogether, the companies in these two SEZs have generated sufficient jobs, and exported almost $4 billion worth of goods in 2010.

It is pertinent to note that both these zones lie within heavily populated urban areas, with much of Filipino SEZ exports being rendered in dense urban areas as evidenced by TABLE 1.3.
India SEZs

Under the SEZ act of 2005, India officially granted permits to the foreign investors to establish its SEZs. The first ever Asian SEZ was deployed at Kandla in India in 1965, recording third such zone in the world. As the project was regulated from the government itself, consequently, the project failed to fulfil the proposed benefits. In 1998 the SEZs increased to 8 which employed around 95000 workers. This figure declined acutely unless the government officially approved the SEZ bill. Currently, 70 percent of the India’s inflow of FDI is attributed towards the SEZs especially located in Maharashtra, Delhi, Karnataka, Tamil Nadu, Andhra Pradesh and Tamil Nadu. On the other hand, the number of employees have surged to 178,000 against 95000. Although stacking up these numbers against the unemployed individuals is inconsequential, as an immense sum of people are entering the labour force, however, keeping intact the situation of inaccessibility of alternate opportunities, these jobs are nothing more than a bliss. Only 20 percent of the worker have been identified migrating from rural to urban areas, indicating slow pace of industrialization.

The performance of India’s exports have subsequently improved, becoming more export oriented. Nevertheless, the exports from these specified zones constitutes only 6 percent of the total exports of India. More precisely, exports worth US$ 5,097 million are contributed by those SEZs operating under the direct control of the Central Government of India. Whereas, exports from the SEZs under the control of state government and private sector constitutes worth US$ 1861 million, resulting almost US$ 7,000 million of exports.

To improve the pace of economic growth and development of India, necessary steps should be taken. First, the policy makers should make enabling administrative procedures to get the job done which includes single window mechanism as practiced in Cambodia and other countries. Secondly, strengthening the infrastructure which certainly includes roads, railways, electricity, easily accessible water etc., this usually attracts the foreign investors.

African SEZs

Several SEZs have been employed in Africa, however, at this stage the scale of SEZs does not matter rather there exists evidences representing sluggish growth of GDP. On the other hand, its global counterparts like Vietnam and Bangladesh have somehow managed to create jobs on exponential rate, over the past decade. Nevertheless, in case of African zone programs, the trend in the job structure and the exports have been examined identical. Both of these rapidly amplified in the first half of the decade but soon declined radically. TABLE 1.4 reveals the relatively poor growth trajectory of African SEZs in comparison to their global counterparts.

African zones which merely depend upon its garment sector, especially, in Kenya and Lesotho, the unemployment rate instead of decline increase drastically in these specific regions. The current situation declares a 15 percent decline in the employment rate of Lesotho’s garment sector. Whereas, in Kenya’s EPZs, the employment rate has deteriorated 20 percent. In Ghana, the volume of exports rapidly raised but still the job growth only documented 4.5 percent since 2004. Same was the case in 2005 and 2008, where the exports were growing by 2.5 times. TABLE 1.5 also exemplifies the poor conditions in which such labour is often kept. Hence, with the exemption of some of the African regions including Mauritius, Kenya, Madagascar and Lesotho, the overall African experience with SEZs have been less than spectacular.

The main reason accused for the failure of African SEZs is the mismanagement of right time and place. Asian SEZ’s success was driven because of determining the appropriate moment in an
an unprecedented era of globalization. Later on, after the SEZs started to develop in different manners and sectors, African SEZs came into the picture. In this way investors were less attracted towards African SEZs. Secondly, the African SEZs failed to fulfil the very utmost requirement, physical and social infrastructure. Other reasons include regularity uncertainty, policy instability, weak implementation capacity etc. These observations can be summed up into instability in the political policies.

**Decipherable Trends in Foreign SEZs**

In the following we discuss some the decipherable trends experienced by the foreign SEZs

- SEZs tend to take almost 5 to 10 years in order to benefit the hosting country in terms of large-scale stable employment and production. This examination has been commonly experienced even by the most successful SEZs in PRC and Malaysia. Therefore, some patience is necessary.

- The SEZs tend to succeed only in those countries which offer to bear significant amount of costs for international manufacturers. Foreign investors usually have alternatives which they can easily avail by withdrawing their investments from the hosting country, if they do not find the advantages of interest. Therefore, such industries should not be considered as captives, rather the projected benefits should be under consideration.

- The main incentive for any foreign firm does not merely depend upon tax holidays. A foremost requirement to encourage foreign investors rests on the political and macroeconomic stability of the hosting country. Tax holiday, on the other hand, is costly in fiscal terms but they only matter at the margin.

- A vital cause identified for not achieving maximum benefit from SEZs is that SEZ firms often prefer to import its input or intermediate good from abroad unless there exists a clear cost advantage in purchasing these goods otherwise. This indicates weak backward linkages with domestic firms because of which the net effect of export becomes negligible, as the input imported and final product exported somehow balances the equation. In this case, domestic firms should strive to provide input with same features/quality, quantity and prices to SEZ firms as per their requirement.

- Early SEZs were used primarily for reducing poverty and creating jobs in the poorest regions of a host country, often with very poor infrastructure. This hindered the establishment and operations of SEZs which enforced the governments to invest heavily in building the infrastructure necessary to make the zones viable, which definitely raised the costs of the hosting country significantly.

**IV. CONCLUSION**

Following a comprehensive comparative analysis, it becomes apparent that African-based Chinese FDI ventures in the realm of SEZs have not yielded the same results as compared to the Asian SEZs which adopted almost similar funding models and frameworks for increasing the host country’s manufacturing output. In the context of CPEC-oriented SEZs, nine zones have established which should take into account the overall problems faced by the SEZs. In the context of job growth in particular, certain measures should be adopted to ensure protection in labour standards and proper skill amelioration of the labour force. The results of comparative analysis clearly exhibits that African SEZs have not rendered appropriate generation of employment and failed to decrease the level of poverty, due to the ineffective frameworks employed. A lack of coherent trade policy with an additional lack of incentive given to investors in many regards, hampered the African SEZs further. On the other hand, Asian SEZs have publicised
complementary additions particularly to SEZ firms which stimulated the prominent socio-economic indicators exemplifying viable job growth and increased skill levels and productivity amongst local labour forces. Thus, it is pertinent for the federal government of Pakistan (Board of Investment), to take into account the issues experienced, the fruits enjoyed and the overall policy framework adopted by both African and Asian countries in order to better refine a system through which Pakistan’s own SEZs can properly flourish as soon as CPEC begins to reach into its fully-operational phase. This additionally follows the set pattern established in the literature review of developing states utilizing and tweaking the Asian economic frameworks to their own context so as to boost their economic growth in a similar fashion.

REFERENCES


TABLE 1.1 - TOTAL EMPLOYMENT STATISTICS IN CAMBODIAN SEZs, 2014

<table>
<thead>
<tr>
<th>Location</th>
<th>Name of SEZ</th>
<th>Year Established</th>
<th>Number of Firms</th>
<th>Total Employment</th>
<th>Employees per Firm (avg)</th>
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<td>17</td>
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<td>Dragon King</td>
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<td>4</td>
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<td>988</td>
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<td>Total</td>
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<td>2005</td>
<td>145</td>
<td>67,889</td>
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TABLE 1.2 - ENTERPRISES BY INDUSTRY AND TYPES OF GOODS PRODUCED, RANKED IN TERMS OF INVESTMENT, EMPLOYMENT, EXPORTS, IMPORTS, AND BALANCE OF TRADE - CHITTAGONG EPZ, JANUARY 1997

TABLE 1.3 - PHILIPPINE EXPORT SHARES BY SEZ REGION: 1990-1998* (%) 

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<thead>
<tr>
<th></th>
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<td>65.11</td>
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<td>68.07</td>
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<td>8.9</td>
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FIGURE 1.4 – SEZ EXPORT GROWTH BY YEARS OF OPERATION

### TABLE 1.5 – A COMPARISON OF CHINESE EMPLOYMENT POLICY IN AFRICAN FDI VENTURES

<table>
<thead>
<tr>
<th></th>
<th>Angola</th>
<th>Kenya</th>
<th>Malawi</th>
<th>South Africa</th>
<th>Zambia</th>
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</tr>
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FIGURE 1.3 – COMPARISON OF SHIPPING ROUTE LENGTH FOR CHINESE COMMODITIES WITH AND WITHOUT GWADAR DEEP-SEA PORT