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Roadmap for Development of CPEC SEZs

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Roadmap for Development of CPEC SEZs

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INTRODUCTION:

Special Economic Zones (SEZs) are developed around the globe mainly in less developed countries as a strategy to industrialize and to accelerate the economic growth. They are demarcated territory with its own fiscal regime different from the one prevailing in the country and managed by single administration⁵. Moreover, they are better connected with markets and are equipped with world class infrastructure such as roads, uninterrupted power, and water supply and facilitation services to run the wheel of industry within SEZ effectively and efficiently.

The growing number of zones is the evidence of the “second best” strategy after the one to open the whole economy to investors⁶. Also, SEZs are considered as the cornerstone strategy for economic growth and a tool of national competitiveness⁷ and economic reforms which have significantly catalyzed the economic growth of the

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⁵ Baissac, Claude. 2011. “Brief History of SEZs and Overview of Policy Debates.”

⁶ Moberg, Lotta. 2015. “The Political Economy of Special Economic Zones.” *Journal of Institutional Economics* 11 (1): 167–190.

⁷ Madani, Dorsati. 1999. *A Review of the Role and Impact of Export Processing Zones*. The World Bank.

countries especially in South East Asian nations and also to some extent in African nations.

SEZs play pivotal role in boosting the economy and hence has gained popularity in the last four decades. The number of SEZs, therefore, has multiplied from 79 in 1975 to more than 5,000 by now in more than 130 countries and is growing. However, not all SEZs are being developed with the same set of objectives. In the 70's and the 80's, SEZs were established to facilitate the industrial development in East Asia particularly in China to strengthen its economy. In Vietnam SEZs were developed to attract FDI, so played key role to transform its economy. Whereas Malaysia, Philippine and Indonesia used SEZs as a growth strategy. India positioned SEZs as the core element of developmental strategy. As for Latin America, SEZs were setup to facilitate the large manufacturing sectors whereas, North Africa and Middle East leverage their export-oriented diversification through SEZs.

In short, SEZs are developed to achieve different policy objectives which are broadly classified into the following categories;

- a) to attract FDI
- b) to support the economic reforms
- c) to generate employment
- d) to use SEZs as laboratory to test new economic policy

To achieve one or group of these objectives, multitude of strategies are required. Approaching SEZs development in different regions having different regional characteristics with same strategy is not recommended. Strategies should be devised considering the existing economic outlook of the region under consideration.

ECONOMIC DEVELOPMENT STAGES AND CHINESE EXPERIENCE: APPLICATION TO SEZS UNDER CPEC:

The challenges of economic development evolve with the growth of a country and so is the case of SEZ development. Development model, therefore, should look at the regional characteristics and investment climate when devising plan for economic uplift of a region. Porter proposed four stage economic development model for this purpose. The four stages are as follows⁸:

- a) **Factor driven:** This stage is based on supply of the factor of production like natural resource, human resource or the favorable conditions (like climate etc.).
- b) **Investment Driven:** At this stage economies are strong enough to compete in international markets and able to acquire new technologies, knowledge and skills. Therefore, required further investment can be encouraged by the government.
- c) **Innovation Driven:** At this stage economies are not only able to absorb technologies and advancement from foreign investment but also create their own. This is the stage where firms and economies are encouraged to create advanced factors of production.
- d) **Wealth Driven:** This is the last stage where economies are losing competitive advantage and this stage is being related with drop of demand condition, de-clustering, drop in wage rate and employment and monopoly of big firms to influence government policies.

Based on Porter Model, SEZ can be developed keeping in view the stages of development in a particular region. Because different regions within an economy may be at different stages of development; some will be factor driven having sufficient

⁸ Porter, Michael E. 1998. Competitive Advantage of Nations. Free Press.

natural resources to feed an industry, other in development stages already contributing to national economy, while others in more advanced stages ready to become an innovation hub. As for the last stage that is, wealth driven, it is not relevant to our economy, so it is dropped from further consideration.

China has developed 5 state owned SEZs on its costal area since late 70s which have helped establishing of more than 1750 new SEZs as of now. SEZs are developed more or less with the same pattern as presented in the Porter Model. In the first stage SEZ, the focus is on attracting FDI/domestic investment to exploit the regional endowments and generate employment (factor driven). Similarly, second stage SEZ helps diversify the production base by attracting investment of the world class manufacturing companies and promote spillover and knowledge transfer through linkages with domestic firms (investment driven). As for the third stage SEZ, the requirements for its development are presence of the competitive advanced industries in addition to R&D facilities and specialization in one or more sectors (innovation driven).

By applying the same concept to prioritized SEZs under CPEC, it comes out that the SEZs should be classified as First, Second and Third stage SEZs based on the regional characteristics described in the model mentioned above.

TABLE 1: PROPOSED DEVELOPMENT MODEL FOR CPEC SEZs

| S.# | SEZ, Province/Region | Regional categorization | Investment Climate | Proposed Type of SEZs | Key Objectives of SEZs |
|-----|--|-------------------------|--|-----------------------|---|
| 01. | Mirpur SEZ, AJK | Under Developed regions | <ul style="list-style-type: none"> Limited industrial base. Weak infrastructure/ Connectivity. Lack of skilled labour. Unemployment Abundant natural resources. | First Stage SEZ | <ul style="list-style-type: none"> Attract Investment. Create employment. |
| 02. | Mohmand Marble City, KPK | | | | |
| 03. | Bostan SEZ, Baluchistan | | | | |
| 04. | Maqpoondas SEZ, GB | | | | |
| 05. | Allama Iqbal Industrial City, Faisalabad | Developed regions | <ul style="list-style-type: none"> Developed industrial base. Better Infrastructure/ Connectivity. Availability of skilled labours. | Second Stage SEZ | <ul style="list-style-type: none"> Attractive FDI Product diversification Export promotion Strengthen domestic industry through backward linkages |
| 06. | Bin Qasim Industrial Park Sindh | | | | |
| 07. | China Special Economic Zone Dhabeji, Sindh | | | | |
| 08. | Rashakai SEZ, KPK | | | | |
| 09. | ICT Model Industrial Zone, Islamabad | Leading region | <ul style="list-style-type: none"> Advanced environment* R&D facilities Well-developed infrastructure | Third Stage SEZ | <ul style="list-style-type: none"> Improve skills Promote productivity, quality and innovation |

*The capital region has factors including R&D facilities, research institutes in top universities of the country, well developed infrastructure and pool of skilled manpower to initiate innovation valley at small scale in the capital.

POLICY RECOMMENDATIONS:

- **Highly Professional SEZ Authority:** Development, management, maintenance and promotion of each SEZ is a unique and extensive engineering management undertaking which should be carried out by highly professional on-site SEZ authority.
- **Setting up of realistic targets:** Realistic goals and targets should be set up for each SEZ regarding; FDI, exports, value addition, employment generation, net revenue, clusters development, expansion.
- **Precise Timelines for Zone Development:** Project approach should be adopted for the construction of each zone. Different construction work packages (roads, electrification, others) of the project, their planned completion time and cost should be explicitly defined for clear visibility of investors who desire to invest in any of the work package or develop the zone completely. It also gives clear idea to the prospective industrialists about the availability schedule and cost of the industrial plots and is helpful in result oriented marketing.
- **On-Site Full-Time functional one window facilitation:** An on-site full-time functional one window facilitation is must for end to end facilitation of the potential and existing investors and industrialists.
- **Area specific development model:** Some of the SEZs are notified in less privileged areas like Bostan SEZ in Balochistan, Marble city in Mohmand Agency, Maqpoondas in Gilgit, while other are notified in rather developed regions such as Allama Iqbal Industrial City in Faisalabad and Bin Qasim Industrial Park Sindh. The former SEZs are required to be developed as per “First

Stage” of SEZ development strategy (discussed above in the document) whereas the latter needs to be developed according to the “Second Stage” of SEZ development strategy to avoid failure.

- **Incentives:** The First Stage SEZs (factor driven) require financial and fiscal incentives for the investors and developers to invest there. Mostly foreign companies shy away from remote and under privileged areas until and unless suitable financial and fiscal incentives are provided to balance investment risks. Regarding the Second Stage SEZs (investment driven) and third stage SEZ (innovation driven), a comprehensive and long term legal and institutional framework is obligatory to allure investors and build trust.
- **Cost of Land:** Cost of land is the basic prerequisite contributes towards cost of doing business. Hence, the industrial plots should be provided as cheap as possible for all the three-stage types of SEZs. To safe guard making the SEZ as a real estate business, the investors should be bound to develop their site within an agreed duration and should only execute the sale and purchase of land from the on-site SEZ Authority on a basic fixed rate.
- **Industry specific incentives:** Special incentives should be given to promote specific type of industries within SEZs, like high tech industries, manufacturing, auto, software and hardware technology industries, mineral processing, exportable branded garments, food, and marble which require high financial capital and human capital and have great potential to grow in Pakistan.
- **Forward and backward linkages:** Establishing strong forward and backward linkages are must to make the CPEC SEZs a world-class success stories. The forward link of SEZ is about linking it to the suitable buyers specially the global markets which is possible if the SEZs can attract global brands and their respective

enterprise specially the Chinese manufacturing and export enterprises to build here and export to their existing global customers. Backward linkages connect the SEZs with the local businesses to strengthen the economy and protect the existing industrial base (mostly cottage/small and medium enterprises) by acquisition of inputs from these and making vendors and local strategic partners.

- **Branding and Targeted Promotion of SEZs:** To promote investment in the SEZs as per the best-fit objective needs, it is very important to brand the SEZs to leverage the value proposition and promote these to well defined key prospective investors and industrialists including; Pakistani (both local and overseas), Chinese, and international.
- **Innovative financing of SEZs:** The above given recommendations need big chunk of finance for which globally used innovative financing modes should explored and devised to support the long term sustainable development of the CPEC SEZs.