Evaluation of SEZS policies and implementation and its impact on Industrialization in KP

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Abstract:

In the global shift from geopolitics to geo-economics, economic priorities are driving national policies for socio-economic advancement. The China-Pakistan Economic Corridor (CPEC), a flagship project under China's Belt and Road Initiative (BRI), has immense potential for regional connectivity and economic growth. While CPEC is a strategic framework for industrialization through Special Economic Zones (SEZs), challenges like political instability, inefficient SEZ management, and lack of cohesive federal-provincial policies hinder its success. This study examines the economic and strategic implications of SEZs in Pakistan, particularly in Khyber Pakhtunkhwa, highlighting the importance of infrastructure, legal frameworks, and policy reforms. Recommendations include streamlined governance, sustainable industrial policies, conflict resolution mechanisms, and targeted incentives to attract investments. By addressing these challenges, Pakistan can transform SEZs into hubs of industrial and socio-economic development, aligning with global economic patterns and achieving inclusive growth.

Key words:

China-Pakistan Economic Corridor, Special Economic Zones, Geo-economics, Industrial Policy, Pakistan.

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Introduction

In the current globalized world, international politics has shifted from geopolitics to geo-economics. National policies are driven by economic priorities to maximize socio-economic benefits for the welfare of the public and the state. From a human capital perspective, agricultural products, mines, and minerals, the Asia region, especially South Asia and Central Asia, are very important regions. China, a rising global economic power, is ambitious to extend its economic and trade activities not only in the region but also in the global market.

The geographical position of Pakistan is very important for China's economic expansion towards other economic hubs of the world. However, political uncertainties and chronic economic problems in Pakistan have eroded the prospects of Foreign Direct Investment. In this context, the initiation of the China-Pakistan Economic Corridor under the Chinese BRI project is supposed to be a game-changer for Pakistan in the regional political and economic arena.

The China-Pakistan Economic Corridor (CPEC) is a framework for regional connectivity through rail, road, air, and sea transportation between Pakistan and China. This corridor will provide a window to Afghanistan, the Central Asian Republics (CARs), and Iran to access international markets. Pakistan signed the CPEC Agreement with China in 2015. Under CPEC, there are a number of projects, including Special Economic Zones in Khyber Pakhtunkhwa.

The basic objective of Special Economic Zones is the promotion of industrialization (Reviving CPEC 2020 - Ahsan Iqbal). The project will be fruitful under the Win-Win model, wherein all the stakeholders and state actors involved in the project may collaborate. The potential areas for cooperation and development in CPEC include transport infrastructure, energy hubs, logistics hubs, trade and commerce, and the development of Special Economic Zones for industrialization and socio-economic development.

Problem Statement

The world is shifting from geopolitics to geo-economics in the globalized era to pursue national prosperity. Regional economic connectivity is the hallmark of modern-day national development. Special Economic Zones are one of the instruments for promoting industrialization. Pakistan's geographical location has the potential for economic interconnectivity with China, Afghanistan, the Central Asian Republics, the Gulf, and other regions. However, Pakistan has not benefited from its geographical potential in the context of Special Economic Zones under the China-Pakistan Economic Corridor (CPEC), especially in Khyber Pakhtunkhwa, which is strategically located on the border of Afghanistan and China. Therefore, this paper aims to critically evaluate the Special Economic Zones in Khyber Pakhtunkhwa and their impact on industrialization in the province.

Scope

This study will critically evaluate the policies for the establishment of Special Economic Zones (SEZs) in Khyber Pakhtunkhwa under the China-Pakistan Economic Corridor (CPEC) and their impact on industrialization in the province. The analysis will be carried out from a comparative lens of successful models of SEZs in China, India, and Bangladesh, focusing on policy, legal, and institutional perspectives. Practical and tangible recommendations will be presented to improve the existing regime for SEZs.

Literature Review

This study critically engaged with the literature related to BRI, CPEC, and SEZs in Pakistan, as well as in China, India, and Bangladesh. A comprehensive analysis was conducted of relevant bodies such as KPEZDMC, the Joint Cooperation Committee (JCC), the Board of Approval (BOA), and Provincial SEZs and other economic zones in KP. The relevant legal framework for SEZs was also critically analyzed. This review provided a clear understanding of government policies and narratives. Nevertheless, the study also employed critical literature, such as *Don't Blame the Chinese* by Hoodbhoy (2023). Seminal works on CPEC by Dr. Ishrat ul Abad, Dr. Shahid Rashi, and Mr. Yassir Arafat were also reviewed to uncover the hidden politics and governmental laxity in materializing CPEC-related projects.

A Special Economic Zone (SEZ) is a geographically bounded area with central management that provides benefits based on its physical location within the zone. These zones have separate customs areas to take advantage of duty-free and related liberal laws [World Bank (2009)]. SEZs yield direct and indirect economic benefits, such as employment generation and foreign exchange earnings, as well as knowledge-based urban growth. Looking at global best practices, China has developed SEZs to deliver a wide range of services rather than focusing on a single function [Wong (1987)]. The inter-linkages between these entities have significantly contributed to Chinese progress in SEZs [World Bank (2009)].

Government support creates an enabling environment where planned and coordinated efforts by the private sector enhance resource utilization, leading to increased competitiveness at regional, national, and international levels [World Best Practices, 2020]. China, India, and Bangladesh have fully leveraged the private sector. In contrast, Pakistan has not prioritized the growth of private enterprise development in SEZs [Zeng, 2008]. Political uncertainty in Pakistan has also contributed to the failure of SEZs. Thus, creating SEZs is a challenging task for governments, as numerous cases of failure exist in both developed and developing countries due to political or personal motives [Plummer and Sheppard (2006)]. Pakistan has initiated the development of industrial zones in various regions, but these efforts have not generated the expected results. The reasons for their poor performance include structural issues and a lack of private sector interest in participating in such zones.

Research Methodology

This study is based on a qualitative research methodology. Primary data was collected through interviews with experts in the field, including BOI, KPEZDMC, and CPEC. Secondary data was analyzed from official websites, research papers, policy journals, official statements, and newspapers. An off-the-record discussion was also held with a relevant officer in the KP government[7].

1. Mr. Sami Ullah Wazir, DG Environmental Protection Agency, KP (KP Climate Change Policy and details of accomplishments of EPA, along with HR details, were obtained).
2. Mr. Zeeshan Abdullah, Additional Secretary, Climate Change, Forestry, Environment, and Wildlife Department (A brief prepared by the department for COP28 was obtained).
3. Mr. Adnan Farid, Additional Secretary P&D, and Mr. Sher Azam, Senior Chief of the Environment Section were interviewed, and documents such as the Supporting Climate Change concept note, a brief about the Climate Change Cell, P&D, and details of projects executed for achieving NDCs were obtained.

Analysis

Situational Analysis of potential, preparedness, planning, policies and current status of Special Economic Zones (SEZs) planned under CPEC in Khyber Pakhtunkhwa

Economic potentials Economic Zones in Pakistan and KP

Pakistan's Under the CPEC Project, there are nine prioritized SEZs across the country, one of which is located in Khyber Pakhtunkhwa, namely the Rashakai Economic Zone[8]. Khyber Pakhtunkhwa has 14 existing Economic

[7] The officers expressed views on the condition of anonymity.

[8] After merger of FATA, Mohmand Marble City changed from Prioritized zone to SEZ.

Zones, including two Special Economic Zones: Rashakai and Hattar SEZ[9]. Out of these, only 10 Economic Zones are operational, including Peshawar, Jalozai, Chitral, Gadoon, Hattar, Ghazi, D.I. Khan, Bannu, Nowshera, and Mohmand Economic Zones. The development and management of modern Economic Zones are contributing to economic growth, job creation, skill enhancement, and poverty reduction, fostering a prosperous and progressive Khyber Pakhtunkhwa.

The priority sectors in Pakistan under CPEC include Tourism and Hospitality, Housing and Construction, Information Technology, Automobile, and Textile[10]. Khyber Pakhtunkhwa, with an area of 101,741 sq. km, strategic locations bordering Afghanistan and China, a population of over 35 million, and a GDP contribution of $38 billion, has significant socio-economic and industrial potential that can be harnessed through the SEZ regime. The key potential sectors in Khyber Pakhtunkhwa that can drive economic development are Textile, Energy, Steel, Plastic PVC, Minerals and Gems, Pharmaceuticals, Fruit and Agro-based products, Construction Materials, Marble and Granite, Engineering, and Food and Beverages.

Between 2020 and 2023, nine Economic Zones were established in Khyber Pakhtunkhwa, generating 11,650 direct employment opportunities and mobilizing PKR 131.7 billion[11].

Potential of KP-SEZ

Khyber Pakhtunkhwa (KP) has multiple natural resources, including hydropower generation, oil and gas, large deposits of metallic and non-metallic minerals, marble stones, agriculture, horticulture, livestock and dairy, forestry, and tourism. These resources offer significant potential for the establishment of industrial and manufacturing units at SEZs in the province. The existing SEZs in the province have the potential to attract foreign direct investment, create job opportunities for the local population, promote export-oriented industries, and facilitate the transfer of technology.

Rashakai Special Economic Zone

Rashakai SEZ is the first CPEC industrial cooperation SEZ, being developed in a joint venture between KPEZDMC and China Road and Bridge Company (CRBC), with CRBC holding a 91% share and KPEZDMC holding 9%. The zone is still under development and is not yet operational. The total area of the project is 100 acres, which have been leased to the JV partner, CRBC, for 30 years. The projected development cost is $128 million, with development occurring in three phases. The total leasable area is 778 acres, of which 702 acres are for industrial units and 76 acres are for commercial units.

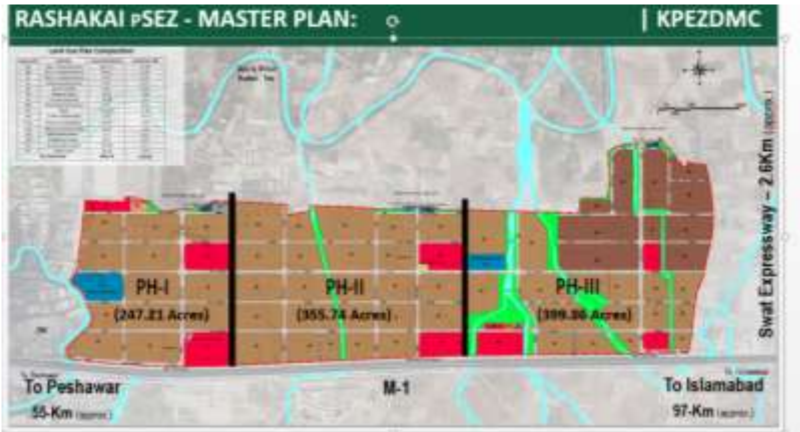
[9] Industrial Communique KPEZDMC 2023

[10] https://invest.gov.pk/sez

[11] Industrial Communique KPEZDMC 2023.

The proposed strategic industrial cluster includes agriculture-based food processing units, automobile and mechanical equipment, marbles, minerals and chemicals, garments and textiles, sports goods, and electronics and electrical appliances. The projected employment generation is 200,000 direct and indirect jobs. The project has the potential to generate $4.0 billion, with a projected economic impact of $29 billion over 25 years.

The project is progressing at a slow pace due to several regulatory issues and overlapping authorities at the federal and provincial levels. Additionally, the project has not been aggressively promoted on international forums to attract foreign direct investment. The slow pace of development has been driven by political instability in the country and inconsistency in priorities.



Economic Impact of SEZ Rashakai

Pakistan is currently facing an economic crisis. Industrialization is the future of Pakistan's economy, and this project will serve as an engine of growth for the country's economy. As indicated by the objectives of the Rashakai Special Economic Zone, through FDI, trade and export, and cluster industrialization, it will bring socio-economic benefits to the country in general and to the province of Khyber Pakhtunkhwa in particular. The key economic impacts of the project are as follows:

- Attract foreign investment in industrialization,
- Increase the country's exports, which will eventually facilitate wealth creation,
- Generate direct, indirect, skilled, and unskilled employment for the local population,
- Promote small and medium enterprises and ancillary businesses for the local population,
- Promote technical education,
- Generate power at the SEZ and sell surplus power to the national

grid.
- Develop domestic industries with modern technology,
- Serve as a hub for regional connectivity and generate transit revenue.

Preparedness and Planning

Policies for SEZs: The study shows that the main requirements for the success of Special Economic Zones are improved infrastructure, a better business environment, and financial incentives in taxation (Lu and Yuan, 2010). The key policy objectives of SEZs are the attraction of foreign direct investment, domestic investment, industrialization, human resource development, and job creation. These encompass a number of policy parameters. However, there is no specific, simplified, decentralized SEZ policy document to smoothly align all ancillary policy frameworks, such as energy policy, investment policy, infrastructural policy, labor policy, land acquisition policy, security policy, tax and incentive policy, export policy, and industrial policy.

From a regulatory perspective, there is no single authority to oversee, plan, manage, and monitor the development and operationalization of Special Economic Zones in the province of Khyber Pakhtunkhwa and to leverage the human resources, natural, and geographical potentials in the province. There are several policy barriers under the domain of the federal and provincial governments for the development and operationalization of Special Economic Zones and industrialization in Khyber Pakhtunkhwa. The mixture of policy frameworks and the absence of a single policy for SEZs are reasons for delays in the operationalization of Rashakai SEZ and Mohmand Marble City in Khyber Pakhtunkhwa. The overlapping policy networks have created uncertainty for developers, co-developers, and enterprises, hindering the robust development of these SEZs.

The following policy initiatives at the provincial and federal levels have been taken for the promotion of Economic Zones:

Revision Khyber Pakhtunkhwa Industrial Policy 2020-30

The industrial sector is not on a growing trajectory, although the province of KP has great potential natural endowment. The key factors for low industrialization in KP are distance from the seaport, law and order situation, lack of requisite infrastructure, energy crisis, financial constraints, and ease of doing business. The revised industrial policy 2020-2030 was introduced for industrialization. The policy is structured on three pillars: revival & rehabilitation, growth, and competitiveness. Special Economic Zones (SEZs) are an important ingredient in the revised industrial policy. The policy includes the following key features:

- Developing critical infrastructure facilities through Public-Private Partnerships (PPP)
- Revival of sick industries
- Prioritizing and incentivizing industrial sectors

- Forming joint ventures with local investors
- Investing in utilizing indigenous natural resources
- Bringing new technology, investing in labor-intensive and export-oriented industries
- Developing skilled manpower for the development, management, and rehabilitation of small and large industrial estates
- Supporting SMEs, creating an investment-friendly environment, and providing facilitation
- Facilitating Ease of Doing Business (EoDB) for industries

Fig: IDEAL POLICY CIRCLE OF SEZs AND INDUSTRIAL ZONES

Absence of Long Term and Sustainable National Industrial Policy

Pakistan's weak industrial base is one of the factors contributing to slow economic growth. There is no single long-term and sustainable National Industrial Policy supporting the overall economic structure. Various industrial policies formulated from time to time in a piecemeal manner have not supported the overall export of the country and have not resulted in the development of small, medium, and large-scale industries, especially in the manufacturing sector. The Ministry of Industries and Production has made a number of policies, including the Auto Industry Development and Export Policy (AIDEP) 2021-26, SME Policy 2021, Electric Vehicle Policy, Mobile Device Manufacturing Policy 2020, Auto Development Policy 2016-21, Fertilizer Policy 2001, and the Auto Industry Development Program 2008. Despite their visions and missions, all these policies have not yet achieved competitiveness through a critical mass of production, contributing to GDP, attracting large investments, or developing technologies and human resources through a well-structured policy framework formulated in consultation with all stakeholders.

A comprehensive industrial policy based on four pillars—Revival, Growth, Sustainability, and Competitiveness—will be instrumental in reviving the economy and connecting SEZs with the economic structure of the country.

PM Youth Program

Pakistan initiated the Prime Minister Youth Program for subsidized financing with an 8.0% markup for youth entrepreneurs to establish small and medium enterprises in the country. The initiative supports small and medium enterprises in the country. Since 2013, under the scheme, 540,000 youth have been given loans totaling Rs. 73.55 billion; however, it has not yielded the desired results in promoting small and medium enterprises. The scheme faces many operational problems, including intricate banking procedures, lack of consultancy for the youth on the utilization of loans, poor monitoring of loans, and challenges in facilitating ease of doing business.

Ease of doing business

Ease of Doing Business is a regime aimed at improving the business climate in the country by facilitating various businesses. However, the ease of doing business is not interconnected through various organizations with a one-window operation among the Board of Investment, Securities and Exchange Commission of Pakistan, Ministry of Commerce, State Bank of Pakistan, and provincial trade authorities.

Taxation Exemption Policy

There are various sector-wise concessions available to entrepreneurs for locating businesses in SEZs. These include Electric Vehicles, Information Technology, Mobile Device Manufacturing, Pharmaceuticals, Food Processing, Textile, and Tourism:

- One-time customs duty exemption on the import of capital goods
- Income tax exemption for 10 years from the date of signing the development agreement (Zone Developers/Co-Developers)
- Income tax exemption for 10 years from the date of commencement of commercial operations (Zone Enterprises)
- No customs duty on the import of plant and machinery for manufacturing industries
- No sales tax on imports of industry-related goods and parts
- Exemption of withholding tax for locally assembled/manufactured electronic items (e.g., phones) on domestic sales
- R&D allowance of 3% for local manufacturers exporting mobile phones
- Pharma raw materials exempt from sales tax

- Zero percent duty on the import of multiple drugs
- Low customs duty on the import of plant and machinery

Land Acquisition Policy

The properties for SEZs are governed by the Special Economic Zones Rule 2013. The rules have the following policy initiatives:

- The SEZ authorities may acquire and hold movable and immovable property for the purpose of carrying out their functions under the Act but shall not sell, lease, mortgage, dispose of, or transfer it in any other manner.
- An SEZ shall use 70% of the area for the operation of zone enterprises.
- An SEZ authority may specify a standard for the efficient use of the land.
- Cancellation of the sub-lease of land for a zone enterprise if the enterprise persistently defaults in fulfilling the requirements of the Act.
- The land/plot is liable to be canceled if the industry is not operational for 24 months.

Rashakai Special Economic Zone

Spread over an area of 1,000 acres, Rashakai prioritized Special Economic Zone (SEZ) is a flagship project of the Government of Khyber Pakhtunkhwa under the industrial cooperation of the China-Pakistan Economic Corridor (CPEC) framework, serving as a CPEC Special Economic Zone. The 1,000-acre SEZ will be developed by CRBC in joint venture with KPEZDMC. The zone is expected to attract a total investment of USD 1.9 billion and generate 200,000 skilled and unskilled jobs.

The zone has the following industrial cluster capabilities:

- Processing and Manufacturing
- Home Appliances
- Pharmaceutical
- Home Building Materials
- Automobile and Parts
- Agriculture and Horticulture
- Wholesale Market/Specialty Mills

Key Feature

- Investors shall avail all benefits and concessions of Special Economic Zones, including:
    - One-time duty-free import on capital goods
    - Income tax exemption for 10 years

- Provision of developed land with amenities (roads, electricity, gas, efficient water treatment plant, and boundary wall)
- Presence of an Industrial Facilitation Office at the site
- Centralized Commercial Area
- 24/7 security through SSU and SSD
- Strategic location, 115 km from Torkham crossing and 779 km from Khunjerab
- Availability of skilled local labor ensured
- 210 MW uninterrupted electricity and 30 MMCFD uninterrupted gas supply
- Emergency services

Current Status

- The Zone is not operational currently.
- 11 industrial units, including one by Chinese Century Steel, have established their units.
- Non-installation of electricity and gas infrastructure.
- No attracted FDI or relocation of labor-intensive and high-tech industries from China.
- Sustainability in political priorities.

Mohmand Marble City

Mohmand Marble City (MMC), planned as an SEZ under CPEC, is located in Michni District, Mohmand, in the Khyber Pakhtunkhwa Province of Pakistan. However, the status of the SEZ changed with the passage of the 25th Constitutional Amendment.
There are many marble reserves in District Mohmand and the adjoining areas of Peshawar, Charsadda, Bajaur, and Khyber District.

Key features

- Geographical location in District Mohmand, 27 km away from Peshawar and adjoining areas.
- Huge reserves of marble in Mohmand and Bajaur.
- 350 acres of land.
- Provision of developed land with amenities for industries.
- Industrial Facilitation Office at the site.
- 24/7 security.
- A project for clustering marble industries in the surrounding areas.
- 11 units are operational, and 47 are under construction.

Economic Impact

- Expected to attract PKR 7 billion.
- 50,000 direct and indirect jobs.
- Potential for mineral processing.
- Granite and dimension stone processing.

- Food and agro-based businesses.

HATTAR SPECIAL ECONOMIC ZONE

Located in District Haripur, it is a flagship project of the KP Government, covering a total area of 438 acres of land.

Key features

- Developed infrastructure including roads, water, and 10 MW power feeders.
- Provision of developed land with amenities for industries.
- Industrial Facilitation Office on site
- 24/7 security.
- Project for clustering marble industries in the surrounding areas.
- 5 units are operational and 44 are under construction.

Economic Impact

- Expected to attract PKR 40 billion.
- PKR 7 billion has already been attracted from China, Canada, and KSA.
- 100,000 direct and indirect jobs.
- Potential for ceramic, steel, and engineering industries.

Comparative Analysis of Rashakai and Hattar

Rashakai Special Economic Zone	Hattar Special Economic Zone
Non-Operational Only 11 have units but due to absence of electricity not operational	Operations with 05 operational units and 44 under construction
A new project	Hattar was already an industrial estate
Absence of energy infrastructure	Availability of
Land acquisition in dollars and not feasible for SMEs	Plot acquisition is in PKR and is suitable for SMEs and LSMs.

Gap Analysis

The gap analysis from a policy, planning, preparedness, and development perspective has identified the following gaps in the Economic Zones and Special Economic Zones in Khyber Pakhtunkhwa:

- Complicated and prolonged procedures for the approval and development of SEZs.

- Overlapping authorities at local, provincial, and federal levels, which hamper the provision of utilities at SEZs.
- The regulatory framework, especially the SEZ Act, subjects SEZs to the jurisdiction of provincial High Courts and civil courts for legal disputes within the operational area of the SEZ, and there is no specialized dispute resolution mechanism for SEZs.
- Political uncertainty in the country causes distrust among foreign firms in developing SEZs and reduces Foreign Direct Investment (FDI) in SEZs.
- Marketing of SEZs for domestic and foreign investment is not being followed aggressively to attract multinational firms to invest in these SEZs.
- High cost of doing business and a complicated land acquisition mechanism.
- The complicated land acquisition regime and high cost of land are not conducive for domestic investors and small and medium enterprises.
- There is no single, long-term, sustainable national industrial policy that supports networking across all sectors of the economy and provides support to SEZs. The industrial policies are short-term objectives that come to an end without results due to shifting political priorities in the country.

The Legal and Intuitional Framework for SEZ

Legal Regime

SEZ Act 2012: The SEZs Act was promulgated in 2012 to support the development of SEZs in Pakistan (Senate of Pakistan, 2023). The Act was later amended in 2016 and is now called the SEZs (Amendment) Act 2016. The amendments were aimed at encouraging SEZ development and making it more investor- and business-friendly. The Act encompasses SEZs and other Economic Zones. It also focuses on defining the roles and responsibilities of different governing bodies and authorities at the federal and provincial levels, as well as the incentives offered to SEZ developers and enterprises.

According to the SEZs (Amendment) Act 2016, an SEZ is defined as "a geographically defined and delimited area that has been notified and approved by the Board of Approval (BOA).

Legal Requirements for SEZs Development

According to the SEZs (Amendment) Act 2016, SEZs can be established in the following three manners (BOI, 2023):

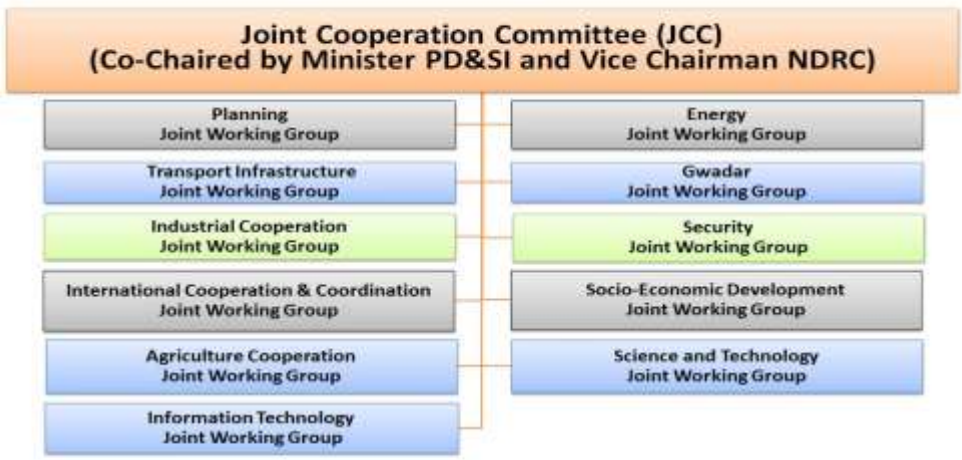
- By private parties exclusively, or;

- By the Federal or Provincial Government, themselves, or;
- By partnership with private parties through Public-Private Partnership (PPP).

According to the SEZs (Amendment) Act 2016, the BOA would approve the zone application submitted by each provincial SEZ authority through the Board of Investment (BOI). The BOA is also responsible for measuring the economic impact of SEZs. Other relevant and responsible agencies are also identified and mentioned in the Act, with a complete governing structure and responsibilities. A graphical framework for developing SEZs as per the SEZs (Amendment) Act 2016 is presented below[12]:

Institutional Framework

The institutional framework for SEZs in Pakistan is given below[13]:



12 Available at https://www.finance.gov.pk/survey/chapters_21/Annex%20III%20SEZones.pdf.

13 Available at https://invest.gov.pk/sites/default/files/2021-10/SEZ_RULES.pdf?gtranslate=en

Provincial SEZ Authority

According to the SEZ Act, an authority shall be established for each province, to be known as the SEZ Authority of that province. Each SEZ Authority shall consist of:

a. Chairperson, who shall be the Chief Minister of the concerned province or a person appointed by the Chief Minister.

b. Vice-Chairperson, who may be the Minister or the Advisor in charge of the investment department, and where no such department exists, any member of the provincial cabinet nominated by the Chief Minister of the concerned province.
c. Chief Executive Officer, who may be appointed by the Chief Minister of the concerned province and may also be the Secretary of the SEZ Authority.
d. Secretary of the provincial investment department, and where no such department exists, the executive head of the provincial investment promotion authority, by whatever name it exists.
e. Secretaries of the provincial industries, finance, commerce, investment, works and services, livestock, agriculture, and planning and development departments.
f. Two members to be appointed by the Chief Minister of the concerned province and two other members to be appointed by the BOA.
g. A member to be appointed by the concerned Chamber of Commerce and Industry where the SEZ is proposed. If there is no Chamber of Commerce, then a member of the Chamber of Commerce from the respective area shall be appointed.

Each SEZ Authority may acquire land in its respective province in accordance with the Land Acquisition Act, 1894 (I of 1894). Each SEZ Authority shall, subject to the approval of BOA, establish its rules and procedures.
Where the Chairperson is not present, the Vice-Chairperson shall chair the SEZ Authority's meeting.

GAP Analysis of Legal and Institutional set up for SEZ

- The SEZs Act deals with CPEC-related SEZs and other economic zones as well. The responsibilities divided between the federal and provincial governments have not been followed strictly.
- The Act envisages provincial SEZs to encourage domestic and

international investors for the promotion and establishment of industrial infrastructure focusing on export promotion, import substitution, transfer of technology, and employment generation. However, as far as KP-SEZA is concerned, there is no physical structure or presence of KP-SEZA in Khyber Pakhtunkhwa. It has been housed in KP-BOIT (Investment Promotion Agency of KP), and

- The CEO of KP-BOIT is charged with additional responsibilities as CEO of KP-SEZA.
- There are no active working groups (WGs) for CPEC SEZs at the provincial level.
- The KPSEZ Authority, notified in December 2012 under the SEZ Act, is literally nonfunctional.
- The most important problem is that Pakistan's special economic zones are not actually special. They get a few benefits but no exclusive legal treatment. For instance, the Dubai International Financial Center or Qatar Financial Center, two of the most successful SEZs in the Middle East, offer a special legal framework where investors are granted a blanket exemption from their respective countries' commercial and civil laws. Zone enterprises do not have to go to courts and wait for years; instead, they can resolve disputes in dedicated local tribunals, offering speedy and low-cost resolution. Without this approach, SEZs in Pakistan will never take off, and before a new law is enacted, a constitutional amendment would be needed.
- The institutional arrangements provided by the SEZ law are overly complicated, with undue powers enjoyed by the federal government, while the provincial governments have little power to fix an SEZ. The approval process involves multiple rounds, but once granted, these approvals don't mean much except for qualification for incentives. Ideally, the approval should encompass pre-approval for a set of activities and shouldn't require further approval by federal or provincial authorities for permits or licenses.
- Time limits for government agencies are provided in the law but without any consequences for not observing them. As a result, these are often violated with impunity. The law provides for the Board of Investment (BoI) to act as a one-stop shop, but the BoI doesn't practically function as a single window.

Labour laws

According to the Act, the same laws for labor and employment shall apply in SEZs as the existing laws in Pakistan.

A Comparative Analysis world's Best Practices in Asia for the SEZs

International Best Practices Model[14]:

The International Good Practices for SEZs Development

- A long-term national development strategy for SEZs
- A business-friendly legal and regulatory framework with strong and decentralized institutional linkages
- One-stop-shop services/one-window operation at the provincial level
- A prototype design for broader national reforms in existing SEZs
- A strategic location with sound infrastructure in and outside the SEZs to attract foreign direct investment and domestic investment
- Effective commercial viability and accessibility to local and international markets
- Environmentally sustainable operational plans with strong monitoring and evaluation systems for SEZs
- Carefully plan, design, and manage operations
- Provision of skills training for an effective workforce for industries
- Undertake continuous technological and industrial learning, innovation, and upgrading
- Strike a good balance between industrial development and social/urban development policies and initiatives

CASE STUDIES: World Best Practices - CHINA, INDIA & BANGLADESH

SEZs Best Practices in Bangladesh

- Adherence to the National Vision 2021, which aimed to transform Bangladesh into a middle-income country by 2021, free from economic disparity, built upon strong democratic foundations and

[14] Aradhna Aggarwal, International Best practices (2021)

well-governed institutions.

- Utilization of Geographical Location and Human Resources: Bangladesh has great potential for investment, including its strategic location between China and India, close proximity to Southeast Asia, a liberal FDI policy, a young workforce, ease of doing business, seafood, jute, and raw materials for garments.
- Utilization of Private Capital: To accelerate economic growth and diversification, Bangladesh established two new agencies in 2010, tasked with leading the development of economic zones and high-tech parks. The Bangladesh Economic Zones Authority (BEZA) was instituted on 9 November 2010, moving away from the EPZ model to SEZs.
- BEZA mainly relies on private capital and expertise to build, own, manage, and operate new zones serving both domestic and foreign markets.
- BEZA's mission is to establish 100 economic zones across the country between 2015 and 2030, with the goal of creating 10 million jobs and $40 billion in exports.
- Strong Linkages Between Economic Zones and Local Industries:
- The development program is supported by a multi-year technical assistance scheme from the Japan International Cooperation Agency.
- The total number of Special Economic Zones is 74, with 20 Private Economic Zones and a total land area of 35,000 hectares.
- Simplified Regulatory Framework: This includes the Bangladesh Economic Zones Authority (BEZA), established under the Bangladesh Economic Zones Act 2010, and working under the Prime Minister's office. It aims to establish economic zones in all potential areas in Bangladesh, including backward and underdeveloped regions, with a view to encouraging rapid economic development through increased industry, employment, production, and export.
- One-Stop Services Act Policy regarding the development, operation, management, and control of private economic zones.
- Implementation of Rules and Regulations.

SEZs in INDIA

- The Special Economic Zones (SEZs) Scheme in India was conceived in 1999 and announced in the year 2000. The basic idea was to establish zones where export production could take place free from all rules and regulations governing imports and exports, and to give them operational flexibility.
- A Special Economic Zone (SEZ) is a specifically delineated duty-free enclave, which shall be deemed to be a foreign territory for the purposes of trade operations, duties, and tariffs. At present, there are 425 approved SEZs, of which 378 have been notified. The total operational SEZs are 265.

- Regulatory Framework: The regulatory framework includes the Special Economic Zones Act 2005 and SEZs Rules, which codify the simplification of procedures for the development and operationalization of SEZs, with single-window clearance for all financial and infrastructural facilities from central and state governments.
- BOARD OF APPROVAL: SEZs are approved by the Board of Approval. The key incentives under the current regulatory regime include duty-free imports, 100% income tax exemption on export income for SEZ units, no licenses for imports, separate documentation for customs, and the provision of ready-to-use plots.
- The key achievements of the flexible regulatory regime have resulted in the operationalization of 264 SEZs, with 22.84 lakh jobs created for local people and foreign exchange earnings through exports from the operational SEZs.

SEZs in CHINA

- Chinese Special Economic Zones (SEZs) vary in scope and function. The Special Economic Zones include geographically specified areas, free-trade areas, industrial parks, technical innovation parks, and bonded zones that facilitate experimentation and innovation across a wide range of industries.
- Most SEZs in China are located in the coastal region or near major cities with a history or tradition of foreign trade or business, making them better linked to the international market. They also have good access to major infrastructure, such as ports, airports, and railways.
- China's SEZs began in the early 1980s when market-oriented reforms were introduced in selected SEZ areas, such as Shenzhen. These were followed in the mid-1980s by the establishment of open coastal cities, such as Zhangzhou, designed to stimulate economic growth by leveraging their geographical location and economic opening. Building on that experience, central and provincial authorities set up high-tech development zones in the late 1980s to capitalize on global capital, technology, and talent.
- The Chinese government, in the 1990s, created new zones, such as the China-Singapore Cooperation Park, and upgraded existing SEZs to take advantage of new opportunities. Since the beginning of the 21st century, a large number of regional zones have been established to stimulate and anchor regional development.
- Management models followed for the development and operationalization of SEZs are:
- Administrative management, with managerial functions performed by government-instituted administrative bodies;
- Administrative committees, with management by government-appointed committees; and

- Joint management by SEZ partners and government-instituted administrative bodies.

GAP ANALYSIS OF SEZs IN PAKSITAN, CHINA, BANGLADESH AND INDIA

KPIs of SEZs	COUNTRIES			
	PAKISTAN	**CHINA**	**BANGLADESH**	**INDIA**
Land Acquisition	Yes	Yes	Yes	Yes
Policy Frame Work	Not Focused	Focused	Focused	Focuse d
Regulatory Frame Work	Yes	Yes	Yes	Yes
Collaborati on B/w Industries and Technical Institutions	No	Yes	Yes	Yes
Institutions for Skilled Work Force	Yes	Yes	Yes	Yes
Availability of Skilled work force	Nil	Yes	Yes	Yes
Energy Availability	Nil	Yes	Yes	Yes
Utilities	Nil	Yes	Yes	Yes
Laws	Yes	Yes	Yes	Yes
Incentives	Yes	Yes	Yes	Yes
One Stop Facilitation	No	Yes	Yes	Yes
Institutions	Partial	Yes	Yes	Yes
Infrastructu res	Yes	Yes	Yes	Yes
Transport facilitation	No	Yes	Yes	Yes

ICT Adoption	Partial	Yes	Yes	Yes
Labor Market	Yes	Yes	Yes	Yes
Financial System	Nil	Yes	Yes	Yes
Property Right	Nil	Yes	Yes	Yes
Security	Very tight and not friendly	Yes	Yes	Yes
FDI	Yes	Yes	Yes	Yes
Tax Exemption	Partial	Yes	Yes	Yes
Ease of Doing Business	Yes / slow	Yes	Yes	Yes
Cost of Doing Business	High	Low	Low	Low

Lesson learnt from the World Best Practices

- The key lessons learned from China's best practices include developing SEZs with the private sector. The state's provision of good infrastructure, low costs, effective organization and management, policy support, and investment promotion are other useful strategies.
- Optimum utilization of geographical strengths, resources, markets, human resources, and capital is essential for successful SEZs, as learned from China. SEZs in Pakistan should also be located in areas with good transport, logistics, local industry, a high concentration of talent, innovative human resource policies, access to quality financial markets, investment facilities, and resources.
- A comprehensive national industrial policy, as adopted by China and India, is necessary to encourage the development of basic and key industries to promote industrialization, escalate value-added exports, and import substitution.
- Ease of doing business, long-term investment, subsidized power and gas tariffs, and rationalized import duties on raw materials to maximize the global value chain are good strategies to enhance national wealth through SEZs and industrialization.

- A robust link between SEZs and industries is a key factor in attracting FDI and promoting exports.
- Monitoring and evaluation, along with effective review by a high-powered board at national and provincial levels, will lead to the growth of industries and stimulate SEZs, as seen in the case of our three case studies.

SWOT and EETH Analyses

Energy Sector vis-a-vis Industrialization

Strengths

1. Institutional Structure: NEPRA was established in 1997 as a monitoring and supervisory institution for the energy sector.
2. The National Electricity Policy 2021 sets forth the supply of reliable, secure, efficient, and affordable electricity to the country with clear policy guidelines.
3. Pakistan is blessed with abundant natural energy resources, and the government's goal of making Pakistan a low-carbon economy by 2030 relies heavily on hydropower and low-carbon sources such as solar and wind.
4. The power generation mix policy for the sector aims to gradually reduce reliance on imported fuels and move towards optimal utilization of local resources such as coal, hydro, renewable sources, local gas, and nuclear.
5. Focus is on run-of-river hydropower projects where irrigation, flood control, and seasonal storage are not involved.
6. KPK has moved forward by providing off-grid solutions through mini and micro hydropower plants to reduce expenditures.
7. The process of strengthening the electricity distribution system is underway to maximize benefits.
8. The functions of system operators have shifted to IT-based automated systems.

Weaknesses

1. Heavy reliance on imported coal-fired power plants and IPPs drains valuable foreign exchange.
2. Pakistan ranks 110th among 135 countries for reliable electricity provision to its citizens.
3. According to the World Bank, disruptions in the power sector cost the economy the equivalent of 6% of GDP in 2019.
4. Inefficiencies persist throughout the system cycle, including fuel supply, power generation, transmission, distribution, end-user services, and theft.

5. Over 14% of gas is lost during transmission and distribution due to inadequate pipe maintenance and theft, causing gas shortages, idle plants, and gas outages.
6. Poor infrastructure, outdated policies, inadequate implementation, short-term decisions, and theft are the primary causes of power outages in Pakistan.
7. Failure to improve power infrastructure and shift to renewable energy sources.
8. Line losses and outdated transmission lines increase electricity costs.

Opportunities

1. The federal government should focus on utilizing the untapped potential of renewable energy sources such as hydel, solar, wind, and nuclear.
2. Public-private partnerships in hydropower, solar, and other energy forms can spur infrastructure growth, inclusive economic expansion, and job creation in the industry and service sectors.
3. Energy cooperation under CPEC can harness available natural resources.
4. Special focus on attracting foreign direct investments (FDIs).
5. Negotiations with regional and international institutions for further investment in Pakistan's power sector.
6. Small, cost-effective hydropower projects can be built in Northern Areas and KPK, leveraging geographic advantages.
7. Existing public-sector thermal plants should be reviewed and assessed for privatization, leasing, or other options for integration into the wholesale electricity market or retirement.

Threats

1. Differences between federal and provincial governments on royalty issues and interprovincial disputes over the NFC award.
2. Rising Circular Debt: Pakistan's energy sector recorded an all-time high of PKR 498 billion, with overall debt reaching PKR 2,476 billion.
3. Provincial alienation: Nearly 50% of Baluchistan is not connected to the national grid, increasing regional disparities and perceptions of marginalization.
4. Poor transmission networks and technical issues have crippled Pakistan's power sector.
5. Power theft and line losses negatively impact revenue generation.
6. Lack of prioritization for shifting to renewable energy sources like hydel, solar, and wind.

EETH ANALYSIS

Enhancement of Strengths

1. The institutional framework of the energy sector should be strengthened at the federal level.
2. The National Electricity Policy 2021 should be implemented in letter and spirit.
3. Concerted efforts should be made to adopt advanced technology to maximize the efficiency of renewable energy sources.
4. Renewable energy infrastructure development may be enhanced by encouraging private sector investment.
5. The federal government should prioritize building small run-of-the-river dams.
6. The KPK model should be adopted by other stakeholders.
7. Pakistan needs investment to upgrade the distribution system.
8. Digitalization of the power sector is essential.

Eliminating Weaknesses

1. Reliance on imported energy sources must be reduced at the earliest.
2. The federal government should devise an effective policy mechanism for equitable electricity distribution nationwide.
3. The government should upgrade the system to prevent disruptions in the power sector.
4. Develop a robust transmission network that complements generation plans for smooth power dispersal between generating stations and load centers.
5. Strengthen the electricity distribution system through DISCOs.
6. Establish an effective mechanism to reduce line losses and prevent power theft.

Taking Advantage of Opportunities

1. The government should take prompt action to utilize renewable energy sources.
2. Policies related to renewable energy should emphasize private sector participation in grid development and transmission networking.
3. Selection of new projects under CPEC energy infrastructure should be designed for maximum output.
4. Cohesive efforts are needed to attract FDI.
5. New technologies should be adopted to establish modern coal-based power plants, replacing older ones.
6. The government should leverage the geographic location of KPK and Northern Areas for small hydropower plants.

Hedging Against Threats

1. The CCI should resolve royalty issues for power plants, utilizing revised financial models to create a win-win situation for both provincial and federal governments.
2. Investment in renewable energy projects under CPEC can reduce circular debt by lowering import costs.
3. The government should electrify far-flung areas of Baluchistan on a priority basis to prevent perceptions of discrimination.
4. Strict accountability of DISCOs is needed to eliminate line losses.
5. The distribution system must be upgraded.
6. The government should focus on long-term goals for cheap, environmentally friendly power projects instead of coal-powered projects, which could deepen the economic crisis.

SWOT ANALYSIS OF POLICY AND LEGAL FRAME WORK

Enhancement	Elimination	Taking Advantage	Hedge against threat
• Policy reforms • Policy Integration • Policy simplification	• Integrated policy for Industrial development • One window operation • Digitalization • Emphasis on implementation • Making KPSEZA Functional	• Investment friendly environment • Focus on Export oriented industries	• Federal/Provincial Harmony • Quick processing of cases • Utilization of indigenous natural resources

SWOT ANALYSIS OF INSTITUTIONAL FRAME WORK

Strength	Weaknesses	Opportunities	Threats
• BOA • BOCs • BOI • KPEZDMC • CPEC Authority • Rashakai Authority • KPBOIT	• Lack of coordination • On ground working • Beau acratic Hurdles • 18th Amendment	• Institutional Reforms • R&D • Learn from Best Practices	• Government incompetency • Lack of Political will • Political Uncertainty • Weak institutions

EETH OFANALYSIS OF INSTITUTIONAL FRAME WORK

Enhancement	Elimination	Taking Advantage	Hedge against threat
• Institutional Reforms • Innovation in governance • Institutional capacity building	• Effective coordination among various units • Improving Efficiency • Business friendly environment	• Geo political location • World leading economies • Coordination b/w Universities and industry	• Capacity Enhancement • Political Commitment • Political Harmony • Strengthening institution

LOGICAL FRAMEWORK MATRIX

Project Description		Verifiable Indicators	Means of Verification	Assumption
Goal	Economic Development	GDP, Remittances, FDI, Current Account Deficit, FBR Revenue, ,	Websites of State Bank of Pakistan	
Purpose /Outcome	FDI, industrial clusters development, promotion of trade generation of employment and transfer of technology through Development of EZ and SEZs	Exports, Imports, PSDP	State Bank of Pakistan	Economic restructuring Industrial growth Regional trade connectivity
Output	Weak infrastructure, complicated administrative process, financial incentives, weak investment climate, political	Relocation of industrial units to SEZs Transfer of high tech industries	KPEZDMC, Board of Investment, Planning Commission KPBOIT	Decentralization of EZ and industrial policies to provinces Human Resource Development Alignment of energy and

	instability development One stop shop Trade facilitation			communication policies to Economic Zones
Activity	Data Collection Case study model Best practices	Feasible vision and objectives for sound SEZs strategies	World best practices	As above

GAP ANALYSIS OF SEZs AND ITS IMPACT ON INDSUTRIALISATION

ACTIVITY	CURRENT STATUS	DESIRED STATE	GAPS	Responsibility
Regulatory Framework	• Overlapping • Stringent law • Complicated approval mechanism	• Decentralized single authority at Provincial Level • Investor friendly legal regime	• Centralization of authority at federal level • Short term objectives	• Consensus between the Federal and Provincial Governments- final decision by the Federal Government as per Federal List in the Constitution of Pakistan
Industrial Policy	• Non-existence of national industrial policy at Federal Level • Short term objectives • Multiple and piecemeal various policies	• National Industrial Policy with connectivity with all sectors of economy at federal and provincial level • Sustainable and long term objectives	• Weak industrial base which compel the policy for short term objectives • Sick industries in Pakistan • No focus on export oriented manufacturing industries	• • Ministry of Industries and Production of Federal Government in consensus with industries Departments of Provincial Government
Energy Policy	• Energy deficiency • Line losses and high cost of	• More generation of electricity • Low cost	• Switching over to renewable energy source	• Ministry of Energy (Power Division, and Petroleum Division) ,

	electricity • Circular debt • Transmission issue • Non use of renewable energy sources • Purchasing of high cost electricity from IPPs	electricity generation • Renewable energy resources • Strict regulatory regime for IPPs • Capitalize from TAPI or Iran gas pipeline	• Policy intervention against theft and line losses • Strict regulatory regime for DISCOs	Ministry of Water of Federal Government
Economic Zones Special Economic Zones Policy	• Mostly under developed • Weak infrastructure • Not supporting the local industries • Not creating jobs for local • Very limited operations • Most favourable for Chinese Transit and storage	• Boost industrialization • Relocation of high tech industries to Pakistan • Employment generation • Socio-economic development	• Absence of political will which serves only Chinese objectives • No internal control on SEZs policies • Law order situation • Lack of skilled labour • Weak infrastructure including rail, roads and ports • Overlapping authorities and procedures for development and operationalization of SEZs • High cost of doing business • High cost of land	• Decentralized approach for devolving full authority of approval, development and operationalization of SEZ • Human Resources Development at Provincial Level in coordination of NAVTTC • Utilization of SEZs for local and international industrial clusters rather than dry ports.

Conclusion

The global political landscape is driven by geo-economics. Economic development determines political patterns. Economic zones are the mechanism through which many countries have transitioned from underdeveloped to developing and ultimately developed states. Notable examples include China, India, and Bangladesh, which have attracted multinational firms and their production units through the economic zone framework. Pakistan has also embarked on the journey of developing economic zones across the country. Pakistan's geographical location is favorable for the establishment of economic zones. With well-designed and coordinated policies at the federal and provincial levels, these zones can achieve the desired outcomes. However, the current infrastructure and mechanism of SEZs primarily serve China's interests as an alternate trade route rather than fostering intense industrialization in Pakistan.

Recommendations

i. An exclusive act for SEZs should be promulgated by the Federal Government and Provincial Governments separately, clearly defining their respective roles and responsibilities to fast-track CPEC-related SEZs. The existing act addresses both economic zones and SEZs, creating friction between provincial and federal governments.

ii. The KPSEZ Authority, notified in December 2012 and established under the SEZ Act, is currently non-functional. The Government of Khyber Pakhtunkhwa should urgently revitalize and operationalize it, providing necessary physical infrastructure. Presently, it operates on an ad-hoc basis under KP-BOIT (Investment Promotion Agency of KP).

iii. The CEO of KPBOIT is currently tasked with additional responsibilities as CEO of KPSEZA. The Government of KP should immediately appoint a dedicated CEO for KPSEZA.

iv. A strategy should be devised for conflict resolution within and outside SEZs through special SEZ courts, rather than relying on traditional legal frameworks such as high courts and civil courts. This would enable zone enterprises to resolve disputes through dedicated local tribunals offering speedy and low-cost solutions. Without this approach, SEZs in Pakistan will struggle to thrive.

v. The institutional arrangements provided by the SEZ law are overly complicated, with excessive authority exercised by the Federal Government in SEZ approvals, while provincial governments have limited control. The approval process should allow pre-approval for a set of activities without requiring further permits or licenses from federal or provincial authorities.

vi. Although time limits for government agencies are stipulated in the law, there are no consequences for non-compliance, resulting in frequent violations. The Board of Investment (BoI), intended to serve as a one-stop shop, does not effectively function as a single-window service. This issue should be urgently addressed by federal and provincial governments.

vii. Political uncertainty in the country undermines the trust of foreign firms in developing SEZs and making Foreign Direct Investments (FDI). Political leadership across all parties should prioritize economic progress and integrate it into their political manifestos.

viii. Aggressive marketing of SEZs for domestic and foreign investment is necessary to attract multinational firms.

ix. The complex land acquisition regime and high land costs discourage domestic investors and small and medium enterprises. The current dollar cap of 0.15 million dollars should be revised by the Federal Government to attract local investors.

x. There is no long-term, sustainable national industrial policy to support networking across economic sectors and SEZs. Existing policies are short-term and often conclude without results due to shifting political priorities. The Federal Government should develop a comprehensive industrial policy to interconnect SEZs with industries.

xi. The traditional education curriculum should be revised, and technical and vocational education should be provided at primary, higher, and secondary levels in collaboration with the National Vocational and Technical Training Commission.

xii. Soft and easy loans should be offered for establishing Small and Medium Enterprises (SMEs) in the province through the Prime Minister Youth Loan scheme, with proper monitoring mechanisms in place.

xiii. A special SEZ police force should be established in Khyber Pakhtunkhwa to ensure security as outlined in the SEZ Act, 2012, thereby restoring investor confidence.

xiv. The provincial industry department of Khyber Pakhtunkhwa should facilitate the relocation of small and medium industries to SEZs.

xv. The Prime Minister Youth Program should be linked to SMEs within economic zones.

xvi. Given their importance, SEZ development should be integrated into Pakistan's overall growth strategy to achieve inclusive and sustained economic growth.

xvii. SEZs should be promoted as hubs of best practices and self-sufficient enclaves supported by robust infrastructure and service provider firms to foster prosperity in KP.

xviii. The provincial government should actively provide transport, electricity, water, telecommunications, waste disposal, and other infrastructure to link SEZs to global and local supply chains before commercially launching project plots for sale.

xix. SEZ plot allotments or commercial launches should only be initiated once basic infrastructure and facilities are in place. Currently, plots are offered for sale, and development work is started afterward using revenue from plot sales.

xx. Incentives need to be refined. For instance, the one-time exemption from customs duties and taxes on importing plant and machinery discourages zone enterprises from expanding. Similarly, income tax exemptions for a fixed period encourage companies to withdraw dividends rather than reinvesting profits. These loopholes should be addressed in the new policy by the Federal Government.

xxi. The Federal Government should demonstrate the political will to shift existing SEZs from serving as transit stores for Chinese supplies to industrial zones that deliver tangible economic development outcomes for Pakistan.

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