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Policy Brief

Strategic Review of CPEC-SEZs: Progress, Challenges and Future Direction

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EXECUTIVE SUMMARY

This study critically examines the development of Special Economic Zones (SEZs) in Pakistan, with a focus on those established under the China-Pakistan Economic Corridor (CPEC). It identifies key challenges including attracting Foreign Direct Investment (FDI), promoting export diversification, and enhancing employment opportunities. SEZs are pivotal in building the industrial capacity necessary for Pakistan's sustained economic growth, particularly through regional tax incentives and robust infrastructure. However, despite the establishment of 35 SEZs and 9 planned CPEC-SEZs under CPEC Phase II, progress is hindered by security threats, business environments, and other systemic issues.[1]

To address these challenges, the government should consider reducing the cost of doing business by lowering documentation fees, offering electricity at subsidized rates, and reducing land acquisition cost. Furthermore, enhancing job creation through CPEC-SEZs requires implementing policies that boost employment opportunities and aligning vocational training institutions with industry needs. These measures could significantly improve the success rate of CPEC-SEZs, enhance the performance of existing SEZs, and generate positive externalities for the broader economy.

Key recommendations include:

- Amending the SEZ Act 2013 to offer regionally competitive incentives and streamline the investment approval process.
- Establishing vocational training institutions affiliated with SEZs to address the shortage of skilled labour.
- Implementing a One-Window facility across all CPEC-SEZs, with clearly defined roles for federal and provincial governments.
- Establish an office of the respective DG SEZ and staff inside the SEZs, not in federal or provincial capitals.

[1] Board of Investment Special Economic Zone Framework in Pakistan https://invest.gov.pk/sez accessed on 3 May, 2024

- Improving security conditions, particularly in Gwadar, Bostan and Maqpoondas SEZs, to attract foreign investors.
- Reducing the cost of doing business by lowering electricity costs and documentation fees, and by providing renewable energy solutions.
- De-notifying previously declared SEZs that have not met their development goals to refocus resources on more promising projects

Introduction

Special Economic Zones (SEZs) are geographically defined areas within a country where specific economic policies and regulations differ from the broader national framework. SEZs are designed to attract FDI, create jobs, promote industrialization, and generate economic benefits that extend beyond these zones. Globally, SEZs have proven to be effective tools for economic development, with their numbers growing from 500 in 1995 to over 7,000 by 2023[2]. Countries such as China, Bangladesh, India, and Vietnam have successfully leveraged SEZs to accelerate their industrialisation and economic growth.

Pakistan, following global trends, has established SEZs to attract investment, develop industrial infrastructure, and drive economic growth. In 2018, Pakistan had only seven SEZs, out of which six were reclassified industrial estates. Today, the country has 35 notified SEZs, hosting 50 foreign and 600 local industries that have generated 50,000 direct jobs.[3] Under the CPEC framework, nine SEZs were planned, spanning all four provinces, Azad Jammu & Kashmir, Gilgit-Baltistan, and the Federal Capital. These SEZs are expected to play a crucial role in CPEC Phase II, which focuses on industrialisation to attract FDI, develop joint ventures, and enhance Pakistan's export-led manufacturing capacity. However, progress has been slower than anticipated, with only three of the nine SEZs having operational enterprises to date.

Pakistan's SEZ development has historically faced challenges such as poor infrastructure, complex regulatory environments, and security concerns. Despite these hurdles, SEZs remain a strategic tool for advancing industrialization. Drawing lessons from successful SEZs in other countries, this paper identifies critical factors contributing to the success or failure of SEZs, including location, development and management practices, incentive frameworks, and government policies. The paper also highlights the importance of an integrated approach involving both federal and provincial governments,

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[2] Myles, Danielle. "A world ripe for free zones" 12 Oct,2023https://www.fdiintelligence.com/content/feature/a-world-ripe-for-free-zones-82991 accessed 9 May,2024

[3] Board of Investment Special Economic Zone Framework in Pakistan https://invest.gov.pk/sez accessed on 3 May, 2024

with a strong emphasis on enhancing the ease of doing business, reducing the cost of operations, and improving the investment climate to ensure the success of CPEC-SEZs.

Table 1: Special Economic Zones under CPEC

Special Economic Zone	Location	Current Status
Rashakai Economic Zone	Nowshera, Khyber Pakhtunkhwa (KPK)	73 acres of land sold, 18 zone enterprises developed, PKR 66Billion planned investment, PKR 57Billion FDI
Allama Iqbal Industrial City	Faisalabad, Punjab	1058 acres of land sold, 51 zone enterprises, PKR 203Billion planned investment, PKR 46Billion FDI
Dhabeji Economic Zone	Thatta, Sindh	Utilities provided, no zone enterprises yet
Bostan Economic Zone	District Pashin, Quetta, Balochistan	61 acres of land sold, 19 zone enterprises, PKR 2.6Billion planned investment, no FDI
ICT Industrial Model	Islamabad	Feasibility report to be submitted by February 2025, infrastructure development to start by the end of 2025
Industrial Park on Pakistan Steel Mill Land	Port Qasim, near Karachi	Feasibility report submitted
Mirpur Industrial Zone[4]	Mirpur, Azad Jammu & Kashmir (AJK)	178 acres acquired for Phase 1, feasibility report submitted
Mohmand Marble City[5]	Mohmand Agency, KPK	350 acres acquired for development, feasibility report submitted
Maqpoondas SEZ[6]	Gilgit-Baltistan	250 acres acquired for development, feasibility report completed, documentation phase

Source: Board of Investment[7]

[4] Freitas, de Geoff. “Pakistan Fast-Tracks Development of Nine SEZs in the BRI-Backed CPEC” available at https://research.hktdc.com/en/article/MzIwODI0MzA3 accessed on 5 May,2024
[5] Freitas, de Geoff. “Pakistan Fast-Tracks Development of Nine SEZs in the BRI-Backed CPEC” available at https://research.hktdc.com/en/article/MzIwODI0MzA3 accessed on 5 May,2024
[6] Freitas, de Geoff. “Pakistan Fast-Tracks Development of Nine SEZs in the BRI-Backed CPEC” available at https://research.hktdc.com/en/article/MzIwODI0MzA3 accessed on 5 May,2024
[7] Board of Investment Special Economic Zone Framework in Pakistan https://invest.gov.pk/sez accessed on 3 May, 2024

Pakistan's Progress in CPEC SEZs

Among the nine CPEC-SEZs, the Rashakai SEZ, Allama Iqbal Industrial City, and Dhabeji SEZ have been prioritized for development. CPEC Phase II aims to capitalize on these SEZs to enhance industrial cooperation, attract local and foreign direct investment, and boost Pakistan's export-led manufacturing capabilities. Despite the ambitious plans, progress has been slow, with only three SEZs currently having operational enterprises. This sluggish growth underscores the need for a reassessment of the SEZ development strategy in Pakistan.

Historically, Pakistan's SEZ performance has been suboptimal, with no significant success stories in exports or investments directly attributable to SEZs. Drawing on the experiences of successful SEZs worldwide, it is evident that location, effective management, incentive frameworks, and robust government policies are critical to SEZ's success.[8] For instance, while the Allama Iqbal Industrial City has attracted PKR 46 billion in FDI, the Bostan SEZ is struggling due to factors such as a shortage of skilled labour, security concerns, and local resistance to development projects[9]. Addressing these challenges is essential to realizing the full potential of Pakistan's SEZs.

Regional Comparison of SEZs

As Pakistan's CPEC-SEZs are still in the development phase, it is vital to examine best practices from other countries that have successfully implemented SEZs. Countries like China, India, Bangladesh, Vietnam, and Myanmar have managed to attract substantial FDI, create jobs, and boost their industrial capacities through effective SEZ policies.

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[8] Special Economic Zones Performance, Lessons Learned, And Implications For Zone Development: https://documents.worldbank.org/en/publication/documents-reports/documentdetail/343901468330977533/special-economic-zone-performance-lessons-learned-and-implication-for-zone-development accessed on 8 May,2024

[9] Board of Investment Special Economic Zone Framework in Pakistan https://invest.gov.pk/sez accessed on 3 May, 2024

Table 2: Comparative Analysis of SEZ Policies in Asia

Country	Fiscal Incentives	Other Facilities
Pakistan	▪ Custom duties: Exemption on imported plants and machinery, 10% duty on plants for relocated industry. ▪ Income Tax: 5-year tax exemption for developers, 10-year exemption for enterprises.	▪ 3-tier governing board: SEZA, BOI, and BOA. ▪ Proposed One-Stop-Shop for approvals.
India[10]	▪ Custom Duty: Exemption on imported goods/services for SEZs, 100% tax exemption on export profit for 5 years, reduced in subsequent years.	▪ 3-tier administrative setup: Unit Approval Committee, Development Commissioner, Board of Approval. ▪ Single window for all approvals, customs officers on-site.
Bangladesh[11]	▪ Custom Duty: 100% exemption on imports for SEZs, 100% tax exemption for 10 years, reduced thereafter.	▪ 2-tier management structure: Governing Board and Executive Board. ▪ One-Stop Service, solar energy solutions in SEZs, central effluent and water treatment plants.
China[12]	▪ Income Tax: 100% exemption before profitability, reduced rates in subsequent years.	▪ Profit repatriation after capital injection.
Vietnam[13]	▪ Custom duties: Exemption on fixed assets, lower corporate tax for 15 years.	▪ Support for scientific research and innovation.
Myanmar[14]	▪ Income Tax: 100% exemption for 7 years, 50% relief for subsequent years.	▪ One-Stop Service Centre. ▪ SEZs required to employ 75% Burmese citizens after 4 years.

[10] The Special Economic Zones Act: The Governement of India https://sezindia.nic.in/sez-act accessed on 10 May,2024
[11] Bangladesh Economic Zones Authority https://beza.gov.bd/investing-in-zones/incentive-package/ accessed on 10 May 2024
[12] China's Special Economic Zones Attract Foreign Investors:https://onlinevisas.com/international/chinas-special-economic-zones-attract-foreign-investors/ accessed on 9 May 2024
[13] Incentives for Doing Business in Vietnam" Vietnam Briefing. https://www.vietnam-briefing.com/doing-business-guide/vietnam/why-vietnam/incentives-for-doing-business-in-vietnam accessed on 10 May 2024
[14] The Thilawa Speial Economic Zone https://www.myanmarthilawa.gov.mm/incentives accessed on 9 May 2024

Pakistan's SEZ Potential

Despite facing initial setbacks, countries like Bangladesh and India have successfully attracted foreign investors by implementing the right policies and providing targeted incentives. With CPEC entering its second phase, SEZs are once again in the spotlight of Pakistan's policymakers. However, the current fiscal incentives and facilities under the SEZ Act 2013 remain insufficient to meet the competitive regional standards.

China started with 4 SEZs in 1980 and then gradually increased. China's experience with SEZs has been highly successful, contributing significantly to the country's industrialisation. China also has pivotal role in establishing CPEC-SEZs in Pakistan. However, Chinese authorities have expressed concerns about the security conditions, fiscal policies, ease of doing business, and macroeconomic instability in Pakistan. These issues, if not addressed, could undermine the success of CPEC-SEZs. Pakistan must improve its law and order situation, enhance its security perception, and streamline the business environment to attract and retain foreign investors.

Improving the ease of doing business is another critical factor. In the 2019 global ranking, Pakistan was ranked 108th, far behind China, India, and Vietnam. The high cost of doing business, exacerbated by expensive electricity, land acquisition costs, and bureaucratic hurdles, makes Pakistan a less attractive destination for investors. For instance, the commercial electricity rate in Pakistan is Rs. 40.26 per unit for loads exceeding 5 kW, compared to the significantly lower rates in Bangladesh.[15] These high costs pose a burden on zone developers and investors alike.

SEZs can also serve as experimental laboratories for new policies and techniques that can be emulated across the country. China's freeports are an example where financial, legal, labour, and pricing policies were initially tested before being rolled out nationwide.[16]

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[15] "Electricity Per Unit Price in Pakistan" priceware. https://priceware.pk/electricity-per-unit-price-in-pakistan/ accessed on 11 May 2024

[16] Special Economic Zones Performance, Lessons Learned, And Implications For Zone Development: https://documents.worldbank.org/en/publication/documents-reports/documentdetail/343901468330977533/special-economic-zone-performance-lessons-learned-and-implication-for-zone-development accessed on 8 May,2024

Similarly, Pakistan can use SEZs to pilot innovative approaches to FDI attraction, export diversification, and job creation, ultimately generating positive economic spill overs for the entire economy.

A good policy framework for SEZs should focus not only on fiscal incentives but also on facilitating business operations. Simplifying the investment approval process, providing one-stop-shop services, and improving infrastructure are crucial steps that Pakistan must take. The current process of setting up an industrial unit in Pakistan is cumbersome, requiring around 28 NOCs, with no exceptions for SEZ investors. The government's proposal to establish a "One-Stop-Shop" in CPEC-SEZs is a positive step, but its success will depend on resolving the power conflicts between federal and provincial governments.[17]

By addressing these challenges, prioritizing CPEC-SEZs, and improving governance, Pakistan can fully leverage the benefits of CPEC-SEZs to drive industrialization, attract FDI, and create jobs. The Allama Iqbal Industrial City alone is expected to generate 0.6 million jobs, demonstrating the significant potential of SEZs if managed effectively.[18]

Conclusion & Policy Recommendations

Pakistan's SEZs have historically underperformed, but the potential remains for a significant turnaround with the right policies and governance structures. Drawing on the success stories of Bangladesh, China, India, Vietnam, and Myanmar, Pakistan can achieve the policy objectives of CPEC-SEZs by implementing regionally competitive incentives and improving its investment climate.

[17] Ahmed, Amin. "One Stop Shop Proposed for setting up SEZs" Dawn. 9 november, 2023 https://www.dawn.com/news/1787682 accessed on 12 May 2024

[18] Rashid, Dr. Shahid, Muhammad Muzammil Zia and Shujaa Waqar "Employment Outlook of CPEC: A Meta Analysis " https://cpec.gov.pk/brain/public/uploads/documents/working-paper-028.pdf accessed on 20 May 2024

Key recommendations include:

- Amending the SEZ Act 2013 to offer regionally competitive incentives and streamline the investment approval process.
- Establishing vocational training institutions affiliated with SEZs to address the shortage of skilled labour.
- Implementing a One-Window facility across all CPEC-SEZs, with clearly defined roles for federal and provincial governments.
- Establish an office of the respective DG SEZ and staff inside the SEZs, not in federal or provincial capitals.
- Improving security conditions, particularly in Gwadar, Bostan and Maqpoondas SEZs, to attract foreign investors.
- Reducing the cost of doing business by lowering electricity costs and documentation fees, and by providing renewable energy solutions.
- De-notifying previously declared SEZs that have not met their development goals to refocus resources on more promising projects.

With the development of CPEC-SEZs, Pakistan has a unique opportunity to enhance its economic prospects by improving infrastructure, easing business procedures, and providing better fiscal incentives. By doing so, Pakistan can attract foreign investment, drive industrialization, and achieve the broader economic objectives of SEZ development.

Action Matrix

Problem/Issue	Pathways to Solution	How to Implement Each Solution	Actors Responsible	Implementation Timelines
Security	Improve security conditions and perception for both foreign and domestic investors.	Enhance security in CPEC-SEZ areas, especially rural zones, and protect international investors from local turmoil.	Government	5 years
Business Cost	Reduce business costs by lowering NOC and permit fees, and incentivising renewable energy.	Accelerate the setup of One-Window Facilitation in all CPEC-SEZs and simplify industry setup processes.	Government	5 years
Fiscal Incentive and Job Creation	Offer regionally competitive incentives and ensure a job quota for Pakistani nationals.	Incorporate regional incentives in the SEZ Act and mandate a fixed job quota for local citizens.	Government	5 years
Unskilled Labor	Address labour skill gaps by establishing vocational training institutions in SEZs.	Establish and affiliate vocational training institutions with SEZ industries, tailoring courses to industry needs.	Government	5 years
Institutional Framework	Develop a defined institutional framework involving the Federation, Provinces, and private sector.	Define roles for the Federation, Provinces, and include the private sector in the SEZ framework.	Government	5 years
Regional Connectivity	Enhance regional connectivity and market linkages through SEZ managers.	Invite international SEZ managers to build regional connections and foster joint ventures.	Government	5 years

About the Authors

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