

Special Economic Zones in Pakistan: Isles of Excellence or Labs for Policy Reforms?

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PI-06-22

It is encouraging to read about the recent progress on China Pakistan Economic Corridor (CPEC) and the Special Economic Zones (SEZ). Following the signing of the industrial cooperation agreement for the second phase of the CPEC, efforts to populate the SEZs are underway. What then are some of the key reform measures needed to ensure that Pakistan's SEZ deliver on the promises that SEZs offer around the world?

The need to improve investments has been long felt in Pakistan. In order to promote industrialization and exports, Pakistan began setting up Industrial Estates (IEs) in the 1960s, and Export Processing Zones (EPZ) since the 1980s. However, these instruments of investment policy were unable to meet their desired goals amid deterioration of key indicators of investment over the years.

The weak performance of IEs and EPZs can be attributed to a confluence of factors. Several IEs were unable to attain adequate colonization despite fiscal incentives because their administrative authorities could not provide utilities and other necessary infrastructure. In addition, most IEs became a hub of real estate activities, which increased land prices and created disincentives for investments in industrial establishments in those IEs. Similar issues were faced by EPZs,

particularly those owned, developed, and operated by provincial authorities.

In the wake of these underlying issues that prevented IEs and EPZs from becoming successful, Pakistan adopted the SEZ model of industrialization in 2012 with the passage of the SEZ Act 2012. The first SEZs under the Act was notified around 2015-16, coinciding with a major amendment in the law. However, it was not until 2019 that regulatory activities and notification of SEZs picked up.

Pakistan's slow start to SEZs can be attributed to a key lacuna in the SEZ law in its early years, and the presence of real estate activities inside the zones, ala the EPZs and IEs of yesteryears. While both these concerns now stand resolved, the latter particularly through the launch of the Special Economic Zones Management Information System (SEZ-MIS) portal that has put a check on real estate activities, a host of reform measures are still needed to be undertaken to make SEZs successful in the country. Of the several key challenges to SEZs in Pakistan, six are discussed below¹.

1 - SEZ Policy & Clear Objectives

Being the capstone of the Investment Policy 2013, the objective behind SEZs in Pakistan is

1

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stated to be a step towards ease of doing business and to stimulate industrial growth with quality infrastructure. However, these objectives are not clearly spelled out in the manner of a separate SEZ policy document. Global literature suggests that wide-ranging objectives are not always desirable because of the often-competing priorities, and a lack of dedicated organization to prepare detailed policy and regulatory framework. Nevertheless, clearly spelled out objectives are needed to guide policymaking, including design of regulations and incentives, site selection for SEZs, industry clusters, and the selection of zone enterprises.

At present, Pakistan has multiple overlapping instruments of investment policy. There are provisions for SEZs under the SEZ Act 2012 (including one being considered for Gwadar); IEs under provincial industries departments; and Special Technology Zones under the Special Technology Zones Authority (STZA) Act 2021.

In addition, the EPZ Authority has plans to establish new zones, including one at Gwadar, under EPZA Ordinance 1980. A Gwadar Free Trade Zone is also being set up under a separate concession agreement and does not come under the SEZ or the EPZ law, whereas as per Digital Pakistan Policy, the Ministry of IT & Telecom plans to recommend incentives for technology SEZs under the SEZ Act. The latter is in addition to tech zones planned under the STZA Act. Moreover, there have also been instances when different budgetary measures have given special incentives to industries outside the SEZs, which erodes the special fiscal incentives provided to enterprises inside the SEZs.

While these overlapping instruments offer choices to prospective investors, they also end up competing for the same investors, add complexity to governance, and therefore may prevent SEZs from realizing their potential. In light of these challenges, Pakistan needs to develop a detailed SEZ policy to guide the evolving legal framework and relevant facets of industrial policies. Equally important is the reconciliation of the SEZ policy with other

instruments of investment policy, such as the Special Technology Zones Authority (STZA) and Export Processing Zones Authority (EPZA), and with various federal and provincial industrial policies, economic growth frameworks and budgetary measures.

2 - One Stop Shop

Among the policies that make SEZs 'special' from the rest of the industrial areas is an environment insulated from weak governance and overall difficulties of doing business. To that end, one stop shop (OSS), also known as one window operation, is a key intervention. The OSS reduces delays and uncertainty around securing registrations, permits, licenses, and approvals as well as provision of public goods from multiple governmental agencies. However, in Pakistan, the OSS is not functional amid overlapping responsibilities between various federal and provincial level SEZ-related authorities for the provision of various public services in SEZs, and zone operations.

Two major challenges relevant to OSS stand out: the lack of OSS authority, and weak integration of policies across the board. For instance, some SEZ developers and provincial investment promotion agencies (IPAs) have launched online portals for various government applications and registrations. However, the portals are one stop windows that only lead to other windows i.e., the portals lead to websites or portals of other government departments where processing of applications and registrations is business as usual. Similarly, some SEZ developers and provincial IPAs have set up physical offices within SEZ boundaries to facilitate investors. However, the staff in these offices are not empowered to take swift decisions, nor are there separate rules and procedures defined for SEZs.

This is unlike international best practices, where the SEZ laws empower various tiers of governments to exempt SEZs from the rules and procedures that typically slow the process of the delivery of public goods to the SEZs.

2

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3 - Legal Environment

Pakistan does not fare well in the legal environment with respect to business. Both local and foreign investors often face weak contract enforcement, and delays in case filing, trial, judgement, and enforcement of court decision. However, the current SEZ law does not insulate SEZs from the existing legal system, nor has it provided for swifter provision of justice. In fact, it disputes between different SEZ-related parties, the current SEZ law assigns exclusive original civil jurisdiction to the District Court or the High Court of the district/province in which the SEZ is located.

One way to address this challenge is to amend the SEZ law such that it gives the recently formed Commercial Courts in Punjab, a jurisdiction to SEZs in the Punjab province. Other provinces, which do not have a legal framework for commercial courts at present may be encouraged to pass their own laws to set up commercial courts, particularly with defined timelines for the dispensation of justice for SEZ-related legal disputes.

In the medium to long term, another solution could be to introduce international judges by setting up international commercial court with strong arbitration rules for SEZs to increase the trust of foreign investors. Since the proceedings and judgements of these courts are under British common law, the model for international commercial court has been a success in several countries in recent years.

4 - Skilled Labour

The current SEZ law in Pakistan also does not insulate the SEZs from labour and employment laws applicable in the rest of the country. For instance, the blanket application of minimum wage without considering the difference in cost of living of workers in different parts of the country creates disincentives for businesses. Dynamics like these need to be revisited to improve business environment and cost of business inside the SEZs.

Moreover, the current SEZ framework in Pakistan does not offer any incentive to zone enterprises for labour training, which is unlike the dynamics in several successful SEZs

around the world. For instance, in Philippines, SEZ enterprises get additional tax deductions for labour training expenses; or Slovak Republic and Serbia offer grants and aid for training and re-skilling labour, Albania allows tax deductions equivalent to 200 percent of the training costs; and Malaysia runs labour training programme on PPP basis for enterprises inside the zones.

In addition to improvements along these lines, there is a need to assess the supply side of labour across various vocations and skills near the locations where SEZs are proposed to be built. These assessments are needed alongside planning for the provision of lodging and transportation of workers, including Chinese workers.

5 - Zone Operation & Maintenance

The current SEZ framework allows developers to set up captive power plants or install hydel power generators. In addition, the cabinet has also approved the decision to allow developers to purchase gas, electricity and other utilities in bulk and supply the same to enterprises inside the SEZs. While this is encouraging, there is no separate framework of incentives to run SEZs on a sustainable commercial basis.

The current SEZ law and regulations in Pakistan focus on first-time colonization of the zone, with little focus on operations and maintenance of the SEZs in the long run. For investors, this is a concern over long-term sustainability of the SEZ projects given Pakistan's experience with IEs and EPZs in the past. This is because successful SEZs earn from services rather than sale of plots. Plot sales generate one-time revenue, which is often used for setting up another SEZ or is paid off as dividends to the developer.

For SEZs to be sustainable, developers and operators need a source of continuous inflows, such as income from various services. These may include captive power, RLNG, warehousing services; effluent treatment plants, labs for quality standards; and setting up for-profit vocational training institutes. A separate framework that covers these aspects can help provide necessary direction for long run sustainability of SEZ projects whilst checking monopolistic behavior within the

3

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SEZ boundaries.

6 - Monitoring & Evaluation

Effective Monitoring and Evaluation (M&E) is a critical part of SEZ policy framework, especially if governments want to expand the policy, legal and institutional arrangements within SEZs to outside the zones or want to scale up the number of zones across the country. In Pakistan, there is no separate formal M&E framework for SEZs, whereas the instruments of M&E described in the law are limited.

Under the law, various SEZ related authorities at federal and provincial level are required to publish bi-annual and annual reports and data on the progress of SEZs. However, unlike international best practices where such reports are submitted to the parliament and shared on websites for wider dissemination.

In addition, the indicators and information basis of a much-needed separately spelled out M&E framework has been expanded to include aspects of feedback from investors inside the SEZs; motivational studies of existing and prospective investors; regulatory impact assessments; evaluation of linkages with vendors outside the zones; and manufacturing and other economic activities inside zones. These are needed to both monitor the performance of the zones but also to continuously assess and improve the regulatory and legal environment of the SEZs.

Conclusion:

The SEZs have existed around the world in various shapes and forms for over several decades. Their growing success is owed to the fact that they have emerged as an important investment policy tool to address the problems of low investments, exports, and industrialization. The SEZs address these challenges by providing what is often

conceptualized as an "island of excellence" i.e., the SEZs ensure business-friendly environment within a designed environment, with facilitative institutional, legal, and infrastructural architecture.

Equally important reason behind the existence of SEZs however, albeit an oft overlooked one, is their conception as "test labs for policy reforms", to which end an effective monitoring and evaluation framework of SEZs is paramount. Since developing economies find it difficult to roll out wholesale reform to improve business environment all across the country at once, they use SEZs as a laboratory for policy and regulatory reform experiments, before gradually rolling successful results outside the zones to the rest of the country.

However, in both these two main rationales and conceptions, the SEZs in Pakistan have significant room for improvement. As far as policy reforms is concerned, the current SEZ framework does not envision SEZs in Pakistan as areas that offer special policy and regulatory environment to businesses. In fact, under current SEZ framework, all applicable laws and standards of Pakistan including vis-à-vis environment, employment, procurement, and building code are to be followed, unless specifically exempted, relaxed, or otherwise provided in the SEZ Act. Those exemptions have not been announced yet.

A concerted effort, therefore, is required to address the challenges to the growth of SEZs in Pakistan, by graduating the SEZ framework from one that focuses on first-time colonization to one that also provides direction on operation and maintenance, financing, sustainability, monitoring and operation, and so forth. This also necessitates deliberations over the creation of a separate autonomous SEZ authority that solely focuses on SEZ development and operation in Pakistan.

4

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References

¹This article is a summary of key findings of the SBP's Special Chapter on SEZs titled: Special Economic Zones in Pakistan: Isles of Excellence or Labs for Policy Reforms? The chapter is a part of the SBP's State of Pakistan's Economy report for FY21. For detailed coverage of the challenges and proposed solutions for making SEZs successful in Pakistan, please read the report available [here](#).