Picture courtesy of CPEC Secretariat
Under construction Allama Iqbal Industrial City, Faisalabad

Rethinking SEZs as Instrument of FDI

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Ever since its independence, the Government of Pakistan has tried various approaches to attract investment for industrial development. However, the share of industry in GDP has remained on the lower side (around 20%) when compared with the emerging Asian economies. Initially, industrial estates were developed by the provincial governments in almost all major district headquarters to lure industrial projects through infrastructure and special incentives. In 1980, the policy focus turned towards export led growth and the Government of Pakistan announced Export Processing Zone (EPZ) framework. The experience did not yield desired results and out of the ten EPZs established only five remain somewhat operational. Then came China Pakistan Economic Corridor (CPEC), under which, the Government of Pakistan enacted the Special Economic Zones (SEZ) Act in 2012, establishing both federal and provincial SEZ authorities. At the federal level, the Act established the Board of Approvals (BOA) headed by the Prime Minister. At the provincial level, the SEZ Act set up provincial SEZ Authorities (SEZAs), headed by the Chief Ministers. Due to a variety of reasons, the Government of Pakistan has not managed to develop world class functional SEZs that could attract Chinese, regional and domestic investors. As a result, the planned nine SEZs under the CPEC Framework could not be made functional and the Government is now focusing to get five priority SEZs operational.

The above experience calls for a serious evidence-based rethinking of the SEZ framework as a tool for attracting investment. By definition, the Specialized Economic Zones are long-term initiatives that require cutting edge and predictable government policies, strong economic diplomacy, and proper infrastructure development. Other important considerations are strategic location, integration of zone strategy with the overall development strategy, understanding of the market and leveraging country's comparative advantage. Strong and resilient laws and regulations are integral to achieving these. Clearly, the fundamental question that Pakistan's policy makers need to ask themselves is the potential effectiveness of SEZs as a stand-alone intervention that can create adequate incentives for investors.

Before analyzing the potential policy responses, one must take a look at the country's economic fault-lines that should be the top most filter for any policy intervention. Evidence is clear that the investors have chosen short-term trading options rather than taking positions on log-term expansion of the production base and productivity enhancement that has led to perpetual economic crises, be it the job creation or the perpetual pressure on external account. The structure of economy has not changed for years and it is time to have a cutting-edge industrial revival policy framework that can set the direction for a competitive and sustainable expansion of the industrial base. A serious rethinking on changing the structure of economy is critical as the current investment climate has failed to revive investor confidence. Pakistan's current investment to GDP ratio is less than 13%, one of the lowest among its competitors in the region. As a matter of fact, both public and private sector investment have plunged with the later declining by 25%. It is pertinent to highlight that targeted public sector investment attracts private capital. For that, major issues will have to be addressed relating to the policy consistency, political fragmentation, declining security, lack of commercial dispute resolution and bureaucratic capability.

First and the foremost barrier to economic policy development including the SEZs is the old school mindset of the policy makers and their influencers. There is a high level of dependence on international organizations, bi-lateral partners and a desire to prioritize foreign investors only through government-to-government deals. As a result, a vast number of ill planned infrastructure projects have popped up with a massive increase in the debt burden. The survival of political parties and overall stability is now largely linked to the Pakistani elites' ability to strike a new bargain that will lead to a more stable and equitable model of managing the economy.

Having developed connectivity and power sector related projects over thirty billion dollars under CPEC, it is pertinent to note that regional connectivity and economic zones can only bring desired results if this infrastructure manages to attract private capital targeted towards country's comparative advantage. The policy vacuum remains a huge challenge in Pakistan as projects are perceived as policies without the use of evidence or adaptation to modern financial structuring and project management tools. SEZs in various Asian economies like Cambodia and Vietnam have attracted huge amount of investment due to clear policy incentives and a market-based governance model.

Multiple layers of bureaucracy have not only increased the transaction cost of investors but it has also created confusion about the overall objectives and role of SEZs. Contrasting incentives and broken coordination between the provincial and federal institutions are clearly creating barriers to the functioning of SEZs. There are multiple investment promotion agencies including the recently established Special Investment Facilitation Council (SIFC). Progressive economies in the region have shifted to a delegated model of dealing with key issues of investors like visas, permissions, registration, financing and dispute resolution. The Government needs to close down multiple layers and delegate these functions to a corporate entity led by private sector to facilitate smooth functioning of the SEZs. UAE, Qatar and Kazakhstan are working on this model through their independent financial sectors that facilitate foreign companies. Most of the SEZs in China are managed as independent corporate entities led by professional CEOs.

It is critical for Pakistan's economic managers to give lead to the private sector for reaching out to the interested investors in China, Saudi Arabia, UAE and Qatar. The government-to-government transactions are complicated due to a variety of reasons including lack of capability in ministries, weak audit practices and legal issues pertaining to public asset transfer. In order to facilitate private sector, the Government may pick up winners in the sectors of comparative advantage. These could include value added agriculture and IT services. Insofar as the SEZs are concerned, a package of financial and regulatory incentives will have to be negotiated with the IMF and other key stakeholders to provide level playing field in terms of financing, taxation, utilities and logistics to the attract private capital in these sectors. It will be critical to align these incentives alongside the regional connectivity infrastructure developed under the China Pakistan economic corridor.

Communication between the government and private sector remains weak and business leaders blame Pakistan for lack of policy consistency, repressive taxation, high utility costs, cumbersome procedures, weak contract enforcement and dispute resolution capacity. According to the United Nations Conference on Trade and Development, liberalization of investment policies and investment incentives account for more than 50 per cent of reforms that attract investment. The key lesson for Pakistan is to properly sequence investment climate

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