Special Economic Zones (SEZs) and CPEC: Background, Challenges and Strategies

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Abstract

Special Economic Zone (SEZ) is a fruitful strategy for promoting trade, employment and economic growth in a county. According to International Labor Organization (ILO) (2010), a tremendous growth in SEZs is observed in last 3 decades. For instance, in 1986, there were 176 SEZs in 47 countries; which reached to 3500 in 130 countries in 2006 (Farole, 2010). The objective of this study is to highlight the potential of SEZs for Pakistan Economy. In particular, we want to find the major causes of failure of the existing SEZs and industrial Estates from the context of organizational inefficiency and governance. There are some industrial estates which were established in Pakistan at provincial level to resolve the problem of sick industry; however, we did not experience much success in that case (Nawaz et al., 2015). There are various models of SEZs across the globe like those of India, Bangladesh, Russia and China. China is one of the success stories as far as the functioning of SEZs is concerned. In this study, we want to have a comparative analysis of Pakistan and China in terms of SEZs and, in this way, we want to discuss how rent-seeking, political influence, information and incentives problems, and other governance issues can lead to the failure of SEZs. Alternatively, in the light of CPEC, we would focus on giving policy options for Pakistan by overcoming these issues.

Key Words: **Special Economic Zones, CPEC, Industrial Development, Pakistan, China**

JEL Classification: O16, O47, F21, R10

1. Introduction

Since the signing of $45.6 billion Memorandum of Understanding (MoU) between China and Pakistan, there has been considerable debate on social, print and electronic media with regard to the possible consequences of China Pakistan Economic Corridor (CPEC). On the positive side, CPEC is considered as a game changer as far as trade, market access and regional connectivity are concerned. All of these are expected to enhance growth and create investment and employment opportunities in the country. On the negative side, there is lack of consensus on the selection of routes, the coordination between stakeholders, the allocation of economic zones and other infrastructure projects. Despite, these opposing perspectives, the prospects, in particular for industrial development, are bright in the face of increased market access, larger regional connectivity, and huge infrastructural development.

Industrial development is considered as one of the most reliable strategies to promote long run growth of an economy. Since the last few decades, many nations are adopting industrial development planning to improve their economic growth. The example of the Asian Tigers has been the obvious one. However to pursue this goal, one strategy is to specify areas for industrial development such as business parks, industrial estates, export procession zones, special economic zone, etc. We have experienced these in various countries around the world. China is the leading example in this regard. For instance, China has established almost 1750 Special Economic Zones (SEZs) at provincial and state levels by 2009. It is estimated that, at national level in China, SEZs accounted for about 22% of national GDP, 46% of FDI, and 60% of exports (Zeng, 2010). Moreover, it generated in excess of 30 million jobs in China. Pakistan, like other countries, also endeavored to develop industrial estates, industrial clusters and special economic zone to promote domestic industry and extract foreign direct investment. However, it has not been that successful as the China and Asian tigers are in this policy.

In general, the evidence with regard to the failure suggests that the rent-seeking of industrial class, poor governance are the main factors responsible for failure (Wang, 2013). Alternatively, the industrial class exploits the privileges which are associated with these zones. However, once the privileges are exploited; then, they come to their routine practices instead of trying to be competitive. Second, political influence, governance, and other regulatory issues also create hurdles for the success of these zones (Zeng, 2015). Likewise, the information and incentives problems seemed tohave caused for the failure of SEZs in various economics. Given these, most of the nations, India, china, Bangladesh, Russia have amended the SEZs Act by introducing new reforms to overcome the rent-seeking behavior, political influence, and other governance problems (Wang, 2013; Zeng, 2015). To resolve these issues, the existing literature suggests private SEZs and decentralized decision making is the optimum solution of these problems (Burman, 2006; Nallathiga, 2007). In this study, first, we want to highlight the issues in the existing industrial structure of Pakistan. Second, by making a comparative analysis of China and Pakistan, we want to find the potential of industrial development through China-Pakistan Economic Corridor (CPEC). Rest of the study is organized in four sections. In section 2, we provide the background of SEZs in Pakistan. Likewise, in section 3, we provide the evidence from China. In section 4, we highlight the issues and policy options for Pakistan. Section 5 concludes the paper by focusing on some policy options for Pakistan.

2. Background and Special Economic Zones in Pakistan

Since its inception, Pakistan has been focusing on its industrial development. In order to do so, significant number of initiatives had been taken in the beginning decades. For instance, the establishment of Pakistan Industrial Finance Corporation (PIFC) and Pakistan Industrial Credit and Investment Corporation (PICIC) in 1948, and later, the establishment of Pakistan Industrial Development Corporation (PIDC) in 1952 are the example of such focus. In particular, during the government of Ayub Khan (1958–1969), these policies evolved in a coherent industrial policy. This policy was based on a classical recipe of a society in which a small group of rich industrialists would save more for reinvestment when compared with underpaid workers and poor peasants. Under the policies of import substitution and export promotion, the development primarily focused on the private sector. In this regard, industrialists were favored by the instruments of differentiated tariffs, imports rationing and overvalued exchange rate, and so on. Later, substantial amount of credit was allocated to the industries at subsidized rates under the auspices of the state. These policies achieved higher growth rates in the manufacturing sector of the country. For instance, the share of industrial sector to GDP rose from 6.9% in 1950 to 11.9% in 1965. Likewise, the industrial growth reached almost to 10% per annum during Ayub's Regime. Although, the policy achieved higher growth rates of the manufacturing sector, but it also created a schematized interest group in the form of industrialists elites. However, the subsequent nationalization of 34 industrial units during Bhutto's regime and the transfer of resources to agriculture sector from industry, the industrial growth rate declined to 2% in 1970s from around 11.9% in 1960s. Onwards, there is dichotomous performance of the industrial sector of the Pakistan in terms of growth and diversification. The major factors that are responsible for poor industrial performance, onwards, include poor governance, rent-seeking behavior of the industrialists, geopolitics etc.

The clustering of industries has been remained as a strategy of industrial development since the beginning of the focus on the industrial sector. Accordingly, in Pakistan, various terminologies have been used to identify the clustering of industrial production. For instance Industrial estates, industrial clusters and special economic zones are the most used concepts in this regard. First, an industrial estate is an area consisting of many factories and business in single locality but it is relatively small area than special economic zone with limited liberal economic policies. The industrial failure in 1970s led the government to established industrial estates. Many sick industries forced the government to establish more than 100 industrial estates around the various locations in Pakistan. Similarly, an industrial cluster is a group of interconnected firms of common industry localized in one geographical region that encourages the social and economic development of related community. Pakistan also having some successful working industrial clusters such as; Sialkot Surgical Goods Cluster; Gujarat Ceramic/pottery Industrial cluster; Faisalabad Readymade Garments Manufacturing cluster; Khyber Pakhtun Khwa (KPK) Marble Cluster; Tannery/Leather Industrial Cluster and Gujranwala cluster etc.

A Special Economic Zone (SEZ) is a specific area of the land used to promote industrial growth in a country by providing more lenient economic and tax policies as compare to general economic policies in a country. Successful SEZ offer immediate access to high-quality infrastructure, uninterruptible power supply, clearly titled land, public facilities, and support services. In addition, streamlined regulatory enforcement, simpler business and establishment rules, expedited customs administration, and other special administrative and approval procedures are also offered in such zones. There are a variety of experiences of SEZ across the globe. According to World Bank’s 2008 annual report, "by some estimates, there are approximately 3,000 zones in 135 countries today, accounting for over 68 million direct jobs and over $500 billion of direct trade-related value added within zones."

The SEZ Act was promulgated on September 13, 2012 and later this year the SEZ Rules were notified. The law provides SEZs to be set up by the Federal or Provincial Governments themselves or in collaboration with the private sector under different modes of public-private partnership or exclusively through the private sector. Accordingly, government of Pakistan has promoted five industrial estates such as Multan Industrial Estate Phase-II, Bhawal Industrial Estate and Mainwali, Rahim Yar Industrial Estate, Dera Ghazi Khan and Rawalpindi Industrial Estate, as special economic Zone under CPEC project with expectation of 150,000 jobs creation (DAWN). Board of Investment (BOI), Pakistan approved additional three SEZs in Punjab such as Quaid-e-Azam Apparel Park (QAAP) at M2 near Shaikupura Interchange, Industrial City located on Trade corridor and M3 near Sahiwal interchange and 225 acres Value addition City near Faisalabad on Expressway. Turnover of Rs 1 trillion is expected with creation of 2,000,000 jobs through these SEZs by its completion in 2018-19 (DAWN, June, 2016). Planning Commission of Pakistan is expecting 27 SEZs to setup across country under CPEC by introducing Gwadar SEZ as first model based on area of 3000 acres on special discretion of China. The distribution of SEZs will be as follows: eight SEZs in Khyber Pakhtunkhwa, seven in Punjab and Baluchistan each, three in Sindh while Gilgit-baltistan and Islamabad will have one, one each (DAWN, Jan 2016). These expected SEZs are as follow:

Khyber Pukhtunkhwa:

1.	Hattar Industrial Estate		
2.	Mansehra Marble and Granite Industrial Estate		(80 acres)
3.	Nowshera Industrial Estate	(manufacturing)	(1,000 acres)
4.	Chitral Industrial Estate	(food processing)	(80 acres)
5.	Ghazi Industrial Estate	(manufacturing)	(90 acres)
6.	D. I. Khan Industrial Estate	(manufacturing)	(188 acres)
7.	Bannu Industrial Estate		
8.	Karak Oil Refinary	(1.00,000 barrel oil per day)	

Punjab:

1.	Pind Daden Khan Industrial City	largest SEZ	(10,000 acres)
2.	Multan Industrial Estate-II		(80 acres)
3.	Rahim yar Khan Industrial Estate		(450 acres)
4.	Bhawal Industrial Estate		(400 acres)
5.	DG Khan Industrial Estate		(3,815 acres)
6.	Mainwali Industrial Estate		(600 acres)
7.	Rawalpindi Industrial Estate		(200 acres)

Baluchistan:

1.	Gawadar Industrial Estate	(3,000 acres)
2.	Lasbela Industrial Estate	(1,290 acres)
3.	Turbat Industrial Estate	(1,000 acres)
4.	Dera Murad Jamali Indsutrial Estate	(50 acres)
5.	Winder Industrial and Trading Estate	(50 acres)
6.	Mini Industrial Estate Khusdar	(50 acres)
7.	Bostan Industrial Estate	(1,000 acres)

Sindh:

1.	Chinese Industrial Zone near Karachi	(2,000 acres)
2.	Textile City near Port Qasim	(1.250 acres)
3.	Marble City Karachi	(300 acres)

Gilgit-Baltistan:

1.	Moqpondass Industrial Estate (Mining & food processing)	(250 acres)

3. Background and Special Economic Zones in China

3.1. Background

Formally SEZs were started in China in late 1970s, as small scale industrial experiments in four districts such as Shen Zhen, Shantou, and Zhuhai in province Guangdong and Xiamen in province Fujian. Chinese administrative structure is as:

By introducing “Open Door” policy reforms in 1978, China has made tremendous growth though SEZs at municipality level. Main objective of SEZs in china creation was to attract foreign investor, which was zero percent before 1978 and People’s Congress has passed first legal rule in SEZs in August 1980, “the Regulation for Guangdong SEZs” (Cai et al., 2008). After successful experiment of SEZs, government has expanded to six new provinces with little modification in the regulations. In support of first experimental SEZs group success, state government has expended 14 other near cities for SEZ by 1984. In next 3 years some closer cities to experimented areas also included in SEZs. Later on in 1990, Pudong New Zone has established in Shanghai while many other cities are declared in SEZs situated around the Yangzi River Valley. Initially the special economic zone status only has given to those municipalities that have better industrial condition, geographical location and human capital, these were targeted areas only. When SEZs successful rate increased in the period of 1992-1994, the State Council has expanded it along the border cities, in autonomous region and in all the capital cities. At this level 222 state-level SEZs were established and 1346 SEZs were at provincial level to improve infrastructure and to attract foreign investor. So this gradual improvement has turned out to be a diversified structure of integration of SEZs along the border, river, inland and remote areas in China. The ratio of municipalities with SEZs starts from 0% in 1978, to 9% in 1985, 24% in 1990, 69% in 1995 and 92% in 2007.

Tremendous growth of SEZs by the right combination of favorable policies and production factors has encourage the Chinese government to initiate economic and technological development zones (ETDZs) also known as China’s national industrial parks. These are relatively smaller than previous SEZs and were 191 national parks in China by March 2013.

High-tech industrial development zones (HIDZs), export processing zones (EPZs), free trade zones (FTZs) and other forms of SEZs were also running side by side in China.

There is key role of institutional reforms within SEZs that encouraged the internal and external factor which led to enhance growth. SEZs are contributing significantly in the GDP, technological progress and innovation such as in some region this figure is between 50% to 80-90% of growth in GDP. Average technological commercialization rate in china is around 10% while this rate is 60% in industrial parks; average technological development in agriculture is 55.2% while in agriculture demonstration zones and agro-tech parks this rate is around 70%. Foreign direct investment rose to $4.1 billion and exported products were $10 billion through these four SEZs by the end of 1980s and in next decade in year 2000 FDI reached to $50 billion. These technological parks are contributing 30% higher income than the normal. SEZs have enhanced the openness through factor mobility, technology transformation and research and development activities around the world.

3.2. Reforms for Foreign Investors

In China four major laws were formulated for foreign investor in SEZs

Private property right protection: this encouraged foreign citizens, overseas Chinese, and compatriots from Hong Kong and Macau to set up enterprises and other establishments on their own or in joint ventures with Chinese partners. The SEZs guarantee to protect the investor's assets, accrued profits and other rights. Prior to 2004, there were no private property rights defined in china outside the SEZs that was a radical reform for foreign investors.

Tax incentives; 100% custom duties were relaxed in addition to 15- 24% reduction in corporate income tax further differentiated on the basis of the technological content of their products, compared to the 33% paid by domestic firms. There are duty free allowances for production materials. There are income tax exemptions for foreigners working in the SEZs as well.

Land use policy; All land is under government ownership under Chinese law, but foreign investors can acquire the right for use of land for business or development purpose lawfully. They may also transfer or lease land rights, or mortgage them for stipulated purposes and terms of use. When foreigners invest in projects encouraged by the state for an operational term of more than 15 years they are exempt from land use fees for five years and pay half the usual fee for the following five years. The land use right is guaranteed for projects that have a total investment of at least US $10 million, or that are considered to be technologically advanced. With a major influence on local economic development the foreign ownership became more liberalized by reducing restrictions.

Labour laws also foreign investors have complete right in hiring or firing their employees in firm without any government influence. Wage reform was undertaken at a time when it was taboo elsewhere in China. The Shekou wage model, adopted in 1983, restructured wages according to three elements: base pay, occupational pay, and a variable allowance. The SEZ's authorities also adopted an official minimum wage and all permanent and most contract workers received a social insurance package superior to anything previously available in China (Sklair,1991). With improving terms of employment and social protections, migrant workers soon began to gravitate to the city from many parts of China; by 1989 more than one million temporary workers already had converged on the Zone. Improvements in labor productivity followed (Ip, 1995), and the beginnings of a “free” labor market emerged by the early 1990s.

A distinctive feature of the SEZ program is its decentralized implementation (Huang, 2012; Xu, 2011). An administrative committee, commonly selected by the local government, oversees the economic and social management of the zone, including approving the FDI projects up to a certain limit, building and improving the infrastructure, and regulating the land use on behalf of the local administration (Zeng, 2011).

Four principles were made clear for Special Economic zones in China:

- Construction primarily relies on attracting and utilizing foreign capital;
- Primary economic forms are sino-foreign joint ventures and partnerships as well as wholly foreign-owned enterprises;
- Products are primarily export-oriented;
- Economic activities are primarily driven by market forces".

From the standpoint of foreign investors, these measures, from tax treatments to land-use arrangements, all translated into a lower cost of production or operation, and, other things being equal, a potential for higher profits. Coupled with improved infrastructure, facilities, legal structure, and administrative framework, these open-minded, investor-friendly policies have helped within a short period of time to turn an inflow of foreign capital into a good. In dealing with foreign direct investment, the SEZs have shown a high degree of flexibility. The flexible arrangements allow them to cope with a wide array of risks and uncertainties, from the convertibility of local currency, operational controls, profit- and risk-sharing schemes, management and marketing structure, to the protection of patents and trade secrets.

Foreign direct investment has increased nearly 30 times from $23.4 million in 1980 to more than $672 million in 1993. Within this category, investments under joint venture arrangements have expanded most rapidly, registering $432.74 million in 1993, which is 171 times as much as it was in 1980. Not only have the joint ventures been the largest component in the category of foreign direct investment, but this mode of investment has shown a rather stable pattern of expansion over time.

3.3. Factors Leading to Success

Many factors lies behind the success of china through SEZs promotion, we can analyze these factors by exploring their significance.

- **Sincere Leadership:**

Among all other factor highly supportive role of government and its strong commitment toward promotion of market oriented economic reforms leads to rapid growth of SEZs in various part of the country. Better infrastructure, decentralization for creating conducing environment "one-stop-shop" polices and many other reforms not only attracted higher foreign direct investment but also generate huge employment opportunities and turnover for country as well.

- **Reforms regarding use of Land:**

SEZs reforms initiated from Shenzhen in 1981, before that land was collectively owned by urban and rural public. But for SEZs permission of use of land for 20-25 year on lease basis has granted. Later land auction system was introduced for commercial areas and industrial areas in 2002 and 2007 respectively.

- **Conducive institutional Environment:**

Complete assurance of secure business and property rights of the foreign investor has provided. In addition to this fiscal and non-fiscal incentive through tax and custom duty relief and strong infrastructure, independence in hiring or firing employees leads the growth of SEZs in China as well.

- **Advancement in production Techniques and Innovative Environment:**

SEZs are one of the major sources of concentration of advance technology, best minds, research and development that make forms knowledge zones around the country. Innovation and inventions took place in this environment which enhance the industrial competition and boost business efficiency.

- **SEZs Placement Edge:**

Locations of SEZs are very crucial for its success or failure that is why in China most of SEZs are formed in light of Chinese culture and traditions. In China SEZs location trend remain closer to river, port, border or railways that create link between international and domestic parties and cause to flourish it in country.

- **Joint Ventures:**

Foreign direct investment has increased nearly 30 times from $23.4 million in 1980 to more than $672 million in 1993. Within this category, investments under joint venture arrangements have expanded most rapidly, registering $432.74 million in 1993, which is 171 times as much as it was in 1980. Not only have the joint ventures been the largest component in the category of foreign direct investment, but this mode of investment has shown a rather stable pattern of expansion over time.

- **SEZ Specific Incentives:**

Industrial production, especially light industrial manufacturing, has been the priority activity in Shenzhen SEZ, and the projects that fell into this category received relatively more generous incentives. The surge in real estate investment also had to do in part with the incentive packages provided by the SEZ. Allowing for foreign investors to take part in infrastructure development, particularly in transportation and telecommunications projects, has been a more recent phenomenon.

4. Opportunities associated with SEZs under CPEC

There is an extended list of opportunities and challenges that need to be faced to transform CPEC into a game changer.

4.1. Fiscal Incentives

For Developers:

One time exemption from all customs duties & taxes for all capital goods imported into the country for the development, operation and maintenance of an SEZ entity is given. Second, exemption from all taxes on income accruable in relation to the development and operation of the SEZ for a period of five years is to be given.

For Zone Enterprises

One time exemption from all customs duties and taxes on imports of capital goods in to the SEZ for installation therein is to be given. Likewise, exemption from all taxes on income for a period of ten years till June 30, 2020 and for five years beyond would incentivize investors to invest there in.

Facilitation Services

The Board of Investment (BOI) would provide one-window facility within the SEZs. Likewise, dry port facility in the zones should be provided in order to facilitate imports of exports of goods.

4.2. General Incentives

The following general incentives are offered in SEZ

- ✓ Gas, Electricity and other utilities will be provided at the zero-point of the Zones
- ✓ Captive power generation is permissible to Developers of the Zones
- ✓ Incentives granted cannot be withdrawn midway
- ✓ Incentives cannot be modified to the disadvantage of an enterprise
- ✓ SEZ Act encourages transparent procedures for establishment of SEZs
- ✓ Best practices for building codes, environment protection and workforce
- ✓ Security arrangements by the respective provincial government
- ✓ For dispute resolution, administrative and alternate dispute resolution mechanism
- ✓ Rules have been framed to simplify the procedures.

Facilities in Export Processing Zones

- Developed land on competitive rates for 30 years
- Duty-free import of machinery, equipment and materials
- Freedom from national import regulations/ custom duties
- Repatriation of capital and profits
- No sales tax on input goods including electricity/gas bills
- Duty-free vehicles allowed under certain conditions
- Domestic market available to the extent of 20%. (exceptions may be available under special circumstances)
- Sales to domestic market are liable for payment of custom duties.
- Presumptive tax at the rate of 1%. Only EPZA is authorized to collect presumptive tax at the time of export of goods which would be final tax liability.
- Obsolete/old machines can be sold in domestic market after payment of applicable duties and taxes
- Defective goods/waste can be sold in domestic market after payment of applicable duties, maximum up to 3% of total value.

Facilities in Industrial estates

- Reinforced Concrete Road Network
- Underground Sewerage System
- Underground Electricity Distribution System
- Walled industrial estate with limited entry/exit points.
- High Pressure Gas Pipelines
- Telecommunications Systems
- Estate Manages Electrical Distribution System
- Fully Equipped Fire Station
- Computerized Weigh Station
- Technical Training Facilities
- Estate Owned Security Arrangements
- Hospital / Emergency Medical services (Social security)
- Potable water.

4.3. Gwadar Export Processing Zone

Exemptions Granted for the development of Gwadar in Finance Bill 2016-17

Income Tax:

- Tax Exemption for 23 years effective 01 July 2016 on profits and gains from business set up in the Gwadar Free Zone Area.
- Tax exemption for 23 years effective 06 February 2007 for specified Chinese companies working on the Gwadar port.
- Tax exemption for 20 years effective 01 July 16 for contractors and Sub-contractors of specified Chinese companies working at the Gwadar Port.

Sales Tax:

Imports by or supplies of materials and equipment to China Overseas Ports Holding Company Limited and its operating companies, their contractors and sub-contractors for construction and operation of the Gwadar Port and development of the free Zone for the Gwadar Port and ship bunker, oils bought and sold to the ship calling on/visiting the Gwadar port having concession agreement with the Gwadar port Authority for period of 40 years and for supplies made by the businesses to be established in the Gwadar Free Zone for a period of 23 years, subject to fulfilment of certain conditions and procedures.

Federal Excise:

Exemption on imports by or supplies of materials and equipment to the China Overseas ports Holding Company Limited and its operating companies, their contractors and sub-contractors for construction and operation of the Gwadar Port and development of the free Zone for the Gwadar Port and ship bunker, oils bought and sold to the ship calling on/visiting the Gwadar port having concession agreement with the Gwadar port Authority for period of 40 years and for supplies made by the businesses to be established in the Gwadar Free Zone for a period of 23 years, subject to fulfilment of certain conditions and procedures.

Exemptions to entities working at Gwadar-Clauses: (126A) to (126D)

- Income derived by following companies from Gwadar port operations starting from 6 February 2007 for a period of 23 years [clause (126A)]:
- China Overseas Port Holding Company Limited (already existed);
- China Overseas Port Holding Company Pakistan (Private) Limited;

- Gwadar International Terminal Limited;
- Gwadar Marine Services Limited; and
- Gwadar Free Zone Company Limited,
- Profit and gains derived by a taxpayer from business set up in Gwadar Free Zone for a period of 23 years from 1 July 2016_clause (126AA);
- Profit on debt derived under a financing agreement with China Overseas Port Holding Company Limited by any foreign lender or local bank having more than 75 percent shareholding of the government or state Bank of Pakistan-Clause (126AB)
- Income derived by contractors and sub-contractors of the following companies from Gwadar port operation a period of 20 years with effect from 1 July 2016 [clause (126AC)]:
- China Overseas Port Holding Company Limited
- China Overseas Port Holding Company Pakistan (Private) Limited
- Gwadar International Terminal Limited
- Gwadar Marine Services Limited; and
- Gwadar Free Zone Company Limited.

Exemption from minimum tax under Section 113:

- Exemption on following entities from application of section 113 regarding minimum tax under clause (11A):
    1. China Overseas Port Holding Company Limited, China Overseas Port Holding Company Pakistan (Private) Limited, Gwadar International Terminal Limited, Gwadar Marine Services Limited; and Gwadar Free Zone Company Limited for 23 years from 6 February 2007. [sub-clause(xxvi)]
    2. Companies qualifying for exemption under clause (126M) of part-1 of second schedule in respect of profits and gains derived from transmission line project. [sub-clause (xxvi)]

Exemption on withholding tax on dividend-clause (38AA):

Exemption on withholding tax on dividend under section 150 to China Overseas Port Holding Company Limited, China Overseas Port Holding Company Pakistan (Private) Limited, Gwadar International Terminal Limited, Gwadar Marine Services Limited; and Gwadar Free Zone Company Limited for 23 years.

4.4. Opportunities for Chinese Investors

Pakistan offers a big market for investment in energy, automobile, textile, surgical equipment, infrastructure, engineering, agriculture, minerals and SMEs. Our focus is also on renewable energy sources such as solar, wind, thermal, and biogas. There exist an immense potential and prospects for Chinese investors in the country with 180 million people, which has a growing middle class (75 million) with increasing needs in different products. Pakistan welcomes Chinese investment in all the sectors to take advantage of liberal and forward looking investment policy.

SEZs will enjoy a 10-year exemption from custom duties and taxes for all capital goods imported into Pakistan for the development, operations and maintenance. Pakistan has now joined the ranks of several countries including China and India in the region where special economic zones have been set up.

5. Conclusion and Suggestions

Labor Policy

One of the most import objectives of CPEC is to welcome foreign capital inflows. However, as far as foreign investment is concerned, there is no clear labor policy for the protection of domestic labor. Enforcement of labor laws has been patchy at best under federal law, and the provinces are in an even weaker position to regulate the labor market. Inspections are almost non-existent, and the low-level labor courts are generally considered corrupt and strongly biased in favor of employers. Clear labor policy under the umbrella of CPEC is essential due to two perspectives. First, we need to have clear policy with regard to the employment of local workers by the foreign investors. For instance, there are no standard requirements allowing Chinese companies to use Chinese or Pakistani labour, and policies and practices, in this regard, varies widely. For example, Egypt had a clear regime for foreign labour: one work permit was allowed for every nine Egyptians employed. The first stage of the Chinese zone in Egypt's Suez region had more than 1,800 local workers and about eighty Chinese staff. Likewise, with regard to Chinese-Nigerian relationship, Chinese partners said that the development phase of the project had a ratio of twenty Chinese to eighty Nigerians. Mthembu-Salter (2009: 3) reported that an agreement negotiated in 2009 between the two sides called for at least 40% of the workforce to be Nigerian. This suggests that the proportion of Chinese could be higher and remained contentious. Mauritius had the most open approach to Chinese workers. The zone was at first expected to use 5,000 workers at full development, half Mauritian and half Chinese. Pakistan should have clear policy in this regard. Second, we should have clear policy guidelines with regard to the protection of rights of the labor employed by foreign investors. In particular, the enforcement of existing laws in accordance with the Industrial Relations Act (IRA) of 2011 is of upmost importance. IRA incorporates details of the union memberships, workers' rights, and working conditions, safety measures etc.

Controlling Internal Rent-Seeking of Industrialists

All the incentives given under the framework of CPEC should be tied clearly with the efficiency perspectives. We have really experienced that mostly industrialists in Pakistan avail incentives and then wind up their established installments once the incentives are lifted as was in industrial estates like Pakistan. A large number of Pakistani industries has been protected and pampered for too long and the result, in many cases, is that even after decades of protection, these industries stay small, inefficient, without scale economics and are not able to export. Even today, the car, sugar, textile and flour industries are subsidised. There have been very few years in our history that these industries have not been subsidised. They are given protection dispensations at will. They are given subsidised land in industrial estates. They are given insider deals in privatisation. These types of protection have three problems. First, subsidies are very hard to remove once given, especially in places where governments are weak, are captured by elites and/or are open to interest group activities. Second, interest groups coalesce around the issue of subsidies and lobby for their continuation. Third, these interest groups are willing to spend a good fraction of the subsidy in ensuring the continuation of the subsidy and in weak states, where corruption is invasive; it is hard to resist the offers.

Solving Coordination Problem between Provinces

Coordination Problem arises when the non-cooperative behavior of agents or stakeholders result in an outcome which is Pareto Inferior. The overall productivity of CPEC clearly rest on the mutual cooperation of federating units. In this regard, the decisions should not be taken separately by the central government; instead, all the stakeholders should be taken into confidence with regard to all decisions. There are three aspects in this regard which need a focus. First, the allocation of routes, i.e. all of the routes should be clearly defined. So far, four routes have been defined. The general notion is that the government had chosen the eastern route (going through Punjab and Sindh) over the western route (going through KP and Balochistan) because the new route has Early Harvest Projects (EHPs) that can be completed in 4-5 years'. Second, the budgetary allocation for the completion of routes should be balanced based on the productivities of all possible routes. Third, the distribution of projects should be based on both need and efficiency perspectives. In particular, all the relevant political parties in Pakistan need to strengthen communication and coordination on CPEC to create favorable conditions for the development projects.

Internal and External Security

In order to exploit the benefits of CPEC, we need to have market access to the neighboring countries like Central Asian Republics (CARs). In this regard, we should have workable relationships with India, Afghanistan, and Iran besides other. This is because economic fundamentals always work within the broader framework of institutional structure which not only incorporates the informal structure but also the formal structure. Only favorable political structure and geo-political position can ensure the success of CPEC, regional connectivity, and improved infrastructure. Likewise, peace in Afghanistan and the North West part of Pakistan like FATA, Khyberpakhtunkha, and Baluchistan are of extreme importance in order to reap the full potentials of CPEC. Moreover, sectarian and ethnic tensions, especially in Karachi bear an important role on the functioning of markets for our international trade.

Focus on our Potential Exports and Imports

We should also work on the micro foundations of our potential exports and imports. Alternatively, we should know the priorities with regard to our exports. As we know, the potential products that we can offer to Afghanistan and CARs countries are to our knowledge flour, vegetables, fruits, meat, fertilizers, and some other grocery products. We really need to expand the list, and improve the quality of existing products in order to be competitive in the presence of rising Chinese exports in the light of CPEC. Likewise, we should know what would be our probable imports after getting market access under the umbrella of CPEC. For instance, one access that we can have with the regional connectivity is to get access to energy market of

CARs. In particular, we should not hesitate in importing the low-cost energy products from either Iran or CARs or some other countries.

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