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BUSINESS WITHIN BOUNDARIES: ECONOMIC ZONES

Economic Zones: Prospects for Success



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Why are Economic Zones a success story? What factors have contributed to its success? Has Pakistan been able to take economic advantage of its established zones? What is in a Economic Zone for businessmen? What should our future course of action be? Find out in this report

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Summary

This research report brings forth facts about the importance of Economic Zones (EZs) and discusses the factors that led to their success. EZs have seen a tremendous growth in numbers since 1970's, and they are now the preferred mode of industrial clustering, especially in the form of Special Economic Zones (SEZ). This has come about due to various advantages that they tend to confer in terms of industrial development. For example, they offer economies of scale in production and costs, act as incubators for new technological developments, spur new research and tend to have positive spillover effects. In the long term, factors like continued coordination and links with research organizations and academia help sustain and improve the performance of EZs.

The success of EZs around the globe presents a good opportunity for Pakistan too, where industrial development has lagged owing to certain factors like poor infrastructure, lack of private sector led initiatives and the poor design and implementation framework whereby costs of establishing and running an EZ tends to be greater than its advantages. The situation in Pakistan remains less than satisfactory. There is an overall failure to move from the simplistic notion of an EZ towards a SEZ. At present, EZs in terms of their establishment and operations largely remain the preserve of various tiers of government. Private sector initiatives remain few despite their increasing trend world over. The research report concludes with recommendations in the form of a future course of action in terms of EZs in Pakistan.

Introduction

The popularity of Economic Zones (EZs) as a policy tool for industrial development, revenue generator, export enhancers and as production agglomerations have grown over time.

There is no specific definition of an EZ or a SEZ, but a few general definitions are as follows:

“SEZs are generally defined as geographically designated areas of a country that are set aside for specially targeted economic activities, and supported through special arrangements and systems that are often different from those that apply to the rest of the country. In different countries SEZ operate through a variety of forms with different functions. They include free ports, free trade zones, industrial development zones (IDZs) and sector development zones. The benefits SEZs offer to private companies include corporate tax reduction or elimination, tariff free trade as well as deregulated labour markets¹”.

As alluded to in the above definition, these kinds of zones can actually be implemented for a very specific purpose. For example, Deng Xiao Peng, the Chinese leader credited with heralding China's economic reforms, stated that

¹ Wendy Nyakabawo (Nov 2014), 'The Geographic Designation of Special Economic Zones', p.1.

‘The EZs are essentially a "laboratory" whereby an "experiment" of state capitalism can be carried out at relatively low social cost. If it succeeds, then significant policy conclusions can be drawn from such experiences and applied to other areas. Even if it fails to fulfil this mission, the "ripple effect", or damages to the country as a whole, could be contained²’.

The report “Business Within Boundaries, Economic Zones: Prospects for Success” takes stock of the development of EZs around the globe, and its comparative development in Pakistan. It is based on available evidence, literature reviews, interviews with relevant government and private sector individuals, historic evidence and the factors that contributed to EZs becoming a success story. This report contributes in the literature by bringing together diverse opinions and dispersed information about economic zones in Pakistan.

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Types of EZs and SEZs

The EZs have various types, most popular one in present times being the Special Economic Zone (SEZ). In general, these zones have a few common characteristics which are:

- a) An EZ is a demarcated, fenced-in geographic area;
- b) It has a single management and administration;
- c) Firms/production units that are part of an EZ can only realize benefits if they carry out their activities within its borders, and
- d) There are special arrangements for these kinds of EZ. For example, different sets of government regulations and duty free access to inputs, etc³.

EZs and SEZs do not comprise a single type of entity or a specific form of agglomeration of production units. In fact, there is much diversity in the forms of both of these around the world. This diversity is based on the different requirements of different countries. Table 1 illustrates the different types of EZs, while table 2 states the different types of SEZs found around the world.

² James Kung, “The Origin and Performance of China’s Special Economic Zones”.

³ Compiled from ‘International Convention on Harmonization and Simplification of Customs’ (1999), Annexure D.

Table 1: Types of General Zones

Type of Zone	Development Objective	Land Size	Location	Activities	Markets	Examples
Free Trade Zone (Commercial Free Zone)	Support Trade	< 50 Hectares	Ports of Entry	Trade related activities	Domestic, re-export	Colon Free Zone, Panama
Traditional Export Processing Zones (EPZ)	Export Enhancement	< 100 Hectares	None	Manufacturing	Export	Karachi EPZ, Pakistan
Hybrid EPZ	Export Enhancement	< 100 Hectares	None	Manufacturing	Export plus Domestic	Lat Krabang, Thailand
Free Port	Integrated Development	> 100 KM ²	None	Multi-use	Export plus Domestic	Aqaba special zone, Jordan
Enterprise Zones, Urban Free Zones	Urban Revitalization	< 50 Hectares	Distressed Urban or Rural areas	Multi-use	Domestic	Empowerment Zone, Chicago
Single Factory EPZ	Export Manufacturing	Upto individual entities	Countrywide	Manufacturing and Processing	Export	Mauritius, Mexico

Table 2: Types of Special Zones

Type of Special Zone	Development Objective	Land Size	Preferred Location	Activities	Markets	Examples
Technology or Science Parks	Promote high tech and science based industry	< 50 hectares	Near universities, research organizations	Hi-tech	Domestic and export	Singapore Science Park, Singapore
Petrochemical Zones	Promote energy industries	100-300 hectares	Petrochemical hubs, energy sources	Petrochemical and other heavy industry	Domestic and export	Laem Chabang estate, Thailand
Financial Services	Off-shore financial service development	< 50 hectares	None	Off-shore financial and non-financial	Export	Labuan off-shore financial services, Malaysia
Software and Internet	Software and IT services development	< 20 hectares	Near universities and Urban areas	Software and other IT	Export	Dubai Internet City, Dubai
Airport-Based	Cargo and trans-shipment	< 20 hectares	Airports	Warehousing and other trans-shipment	Re-export and domestic	Kuala Lumpur airport free zone, Malaysia
Tourism	Integrated tourism development	200-1000 hectares	Tourism areas	Resorts and other tourism	Domestic and export	Baru Island, Colombia
Logistics parks and cargo villages	Logistics support	< 50 hectares	Airports, ports and transport hubs	Warehousing, trans-shipment	Re-export	D1 Logistics park, Czech Republic

Source: 'SEZs: Performance, Lessons Learned and Implication for Zone Development', FIAS (2008)

The global growth of Economic Zones

EZs are not a new concept. In fact, in the days of empire trade, outposts like Papua New Guinea and Gibraltar were hubs of commercial activity and were branded special status by their controlling empires/ states. Italy established its first EZ in 1719, while Sweden established its first in 1785. The first modern day EZ was set up around half a century ago in Ireland (in 1959), and its success led to the gradual development of EZs all around the world. At present, there are an estimated 3,000 EZs⁴ around the globe (in more than 120 countries) that employ more than 70 million and produce output that is worth more than \$500 billion⁵. According to various estimates and studies, 62 percent of the almost 2,300 zones in developing countries are private sector developed and operated⁶. This trend is in contrast to the 1980s, when less than 25 percent of these zones were in private hands. The primary contributor to the rise of private controlled and operated zones was the realization that such facilities can reduce government expenditures considerably, and that their value tends to increase over time when operated by the private sector.

Some economic zone projects have been a marked success. For example, The Subic and Clark free ports in the Philippines account for almost 10 percent of national merchandise exports. The Shenzhen EZ in China has attracted more than \$30 billion in FDI and generates an estimated 14 percent of Chinese exports. Apart from its success, it has transformed the relatively backward town of Shenzhen in a powerful manufacturing hub in China. Thus EZs not only have the power to spur economic activity, but they can also bring other positive factors (like jobs and city development) with their success.

Rationale and advantages of Economic Zones

The objectives of establishing a zone differ by countries. In the developing world, EZs are mostly geared towards export enhancement and for attracting FDI. But in industrialized nations, a substantial portion of such zones are part of urban/marginalized area renewal efforts and product sophistication⁷.

Economic Advantages

Overall, the advantages mainly accrue due to increase in economic activity (through increase in output), job creation and regulations that complement the increase in economic activity. For firms, the advantages mainly come from positive spillovers of geographic concentration, relatively better infrastructure facilities, favorable circumstances (like tax and duty exemptions), better market reach and better prospects of Foreign Direct Investment (FDI) in their ventures. Static and Dynamic advantages:

⁴ In contrast, there were only 79 zones in 25 countries, in 1975. This speaks volumes about the spectacular success of development of EZs in the following decades.

⁵ Statement by Mr. Mukhisa Kituyi, Secretary General UNCTAD, at the 3rd SEZ Summit (2013) in Dubai.

⁶ "SEZs: Performance, Lessons Learned and Implications for Zone Development", FIAS (2008)

⁷ Reference may be made of Madani (1999) 'A review of the role and impact of EPZ's' and Cling (2001) 'EPZ's: A threatened instrument for global economy insertion' for these differences in priorities.

The advantages from EZs can be bifurcated into two types: *static* and *dynamic* advantages. The static advantages relate to the short term, and accrue in the form of increase in exports, increased employment, increase in Foreign Direct Investment (FDI), develop export oriented industries, providing a conducive environment for investment, and to earn foreign exchange. The dynamic advantages relate to the long term, and consist of technology transfers and upgradation, development of a technology base, creating deeper international and national market linkages, development of non-traditional/newer industries (like biotechnology), diversifying a country's industrial base, incentive for more entrepreneurialism, and as an incubator for new and dynamic ideas.

Employment creation

In terms of employment, the EZs do not necessarily employ a huge percentage of world's labor force. By 2010, it employed only 0.21% of the total labor force⁸. But this is a cumulative picture that does not account for variation and importance of EZs within countries in terms of job creation. Moreover, this number signifies only *direct* employment. It is estimated that *indirect* job creation from EZs could be upto 77 million jobs around the globe⁹.

There is sufficient evidence to confirm that clustering of production units inside EZs provides advantages to not only businesses, but also enhance regional and national economic activity. This is not only true of large scale production units, but increasingly true of small and medium scale enterprises (SMEs). In fact, a study by Morosini¹⁰ found that the survival of SME's in the latter half of the 20th century had a lot to do with their association with production clusters. Similarly, the advantages accrued to local and national level economic development have also been confirmed through various studies¹¹. An increase in aggregate economic activity, in turn, means the availability of more jobs and opportunities.

A summary of selected paper findings regarding EZ performance from around the globe is presented in the following table (Table 3).

⁸ International Labor Organization (ILO) database.

⁹ ILO database plus FIAS estimates using the same database.

¹⁰ Morosini (2004), 'Industrial clusters, knowledge integration and performance', *World Development*.

¹¹ For example, see Lundequest and Power (2002), 'Putting Porter into practice? Practices of regional cluster building: Evidence from Sweden', *European Planning Studies*.

Table 3: Performance of Economic Zones around the Globe

Title of study	Year	Author	Findings
The Economic Impact of SEZs: Evidence from Chinese Municipalities, (LSE)	2009	Jin Wang	Collects data from Chinese municipalities from 1978-2007 to gauge the economic impact of SEZs. Finds that the SEZs led to an increase of FDI by 58%, it does not crowd out domestic investment and increases Total Factor Productivity (TFP) by 0.6%.
What Accounts for the Rising Sophistication of China's Exports? (NBER)	2010	Zhi Wang and Shang Jin-Wei	Studies data on Chinese exports from 1995-2005 to determine the nature of export products. It finds that by 2005, Chinese exports had increasingly transformed from simple exports to high tech, value added exports. The main thrust of this transformation came from high-tech zones, which managed to attract substantial FDI.
Special Economic Zones: Facts, Roles and Opportunities of Investment, (International Conference of Engineers and Computer Scientists)	2014	P. Pakdeenurit and N. Suthikarnarunai	EZs, especially SEZs, have the potential to stimulate a country's economic activity and enhance employment. Countries plus producers could realize probable gains in terms of expansion in infrastructure, currency exchange, technological development and specialized labor.
Tax Policy and Urban Development: Evidence from an Enterprise Zone Program, (Michigan State University)	1991	Leslie Papke	Studies the Enterprise Zone program in the state of Indiana (USA), meant to revitalize areas with depressed or low economic activity. Finds that EZs reduced unemployment claims by a substantial 19 percent, and increased the value of business inventories by 8 percent. In short, it was a success.
Unlocking Comparative Advantage through EPZ's in Bangladesh, (WB)	2012	Mustafizul Shakir and Thomas Farole	Study the development and performance of EPZ's in Bangladesh. By 2010, EPZ's employed more than 200,000 people and account for more than 14 percent of Bangladesh's exports. Despite export bias due to policy design of EPZ, increasing linkages have been developed with the local market too. Moreover, production as a whole in EPZ's more efficient compared to production outside it.
Success and Stasis in Honduras' Free Zones, (WB)	2012	Michael Engman	The study finds that the establishment of such zones has not only led to increase in economic activity (especially in the areas where they are located), but also helped in job creation and value addition in products.
Special Economic Zones beyond 2020, (Ernst and Young)	2014	Pawel Tynel and Duleep Aluwihare	Report analyzes the effects of EZs in Poland. It finds that rate of unemployment is lower by 1.5 to 2.8 percent in areas where there are SEZs, the per capita GDP is 3.9 to 7.5 percent higher in the areas which have these SEZs, and that they have managed to attract substantial investment.

What makes an EZ successful?

There is no silver bullet as far as success of the EZs is concerned. Whereas they have been successful in countries like China, there are other places (like in South America and African) where they have failed. The relative success of EZs takes time, and there are a host of internal and external factors that affect its performance. The level of industrial development is very critical in terms of product specialization in a specific geographic locality. This is especially true in the case of SEZs and the long run performance of any EZ. The industrial development and sophistication of a nation, in turn, owes to many factors. Some common factors are as follows:

The right incentives and processes

The development of an EZ is basically an incentive to producers . An incentive offered in one country (like a tax holiday) may not work as effectively in another country. Therefore, the establishment of EZs should be underpinned by an astute/expert analysis of what spurs economic activity? Similarly, the establishment of an EZ should be purely based upon economic calculations rather than political considerations. There are examples of zones¹² that were purely established on political grounds and at a very heavy capital cost, but turned out to be a failure.

Importance of Location

These serve as helpful guides in terms of thinking about setting up EZs. They are 1) proximity to a large market or customer base (for example, proximity to a populous area), 2) proximity to a natural resource like iron ore, 3) concentration due to the presence of a specific technology (like MIT and Sweden's SMIL cluster), and 4) the success of a specific industry in one place having the potential for attracting other firms to that area.

The balance between the public and private presence

Individual firms are considered to be the most important actors of clusters in EZs. It is through their continued efforts that EZs retain their inertia and vitality. Yet there has been a tendency for the state to intervene in the workings of such EZs, especially in times of economic distress. This may undermines the firm's own zest for creativity, hard work and effort. The ability to innovate, make judicious use of resources, productivity, best practices, retention of productive labour, the ability to market products, etc, all are affected if public sector's footprint grows too large. In contrast, clusters where the government has played a mere supporting or facilitating role have been the ones that have been relatively successful.

The importance of consensus and coordination

EZs can only be successful if there is consensus among all actors (public, private and political). A failure to build a consensus may result in the failure of the project altogether. A change in the government, a change in policy, a change in circumstances that may lead to a different line of action (more direct government involvement, for example), etc, are some of the issues that may hamper earlier developed consensus. There needs to a continued coordination process among all the relevant actors so as to maintain the sanctity of the initial understanding. This kind of continued coordination between the firms and the other relevant stakeholders has been documented as a critical factor in the success of the industrial clusters¹³.

Having a clear vision

This point is closely linked to the above stated point of having right incentives. 'Vision', in terms of an EZ, is about developing an extensive, well thought out plan about its

¹² Like Cartagena Free Zone in Columbia.

¹³ Raines (2000), 'Developing cluster policies in seven European regions'.

development and successful working of zone. It is not merely about the setting up of few industrial units in a particular geographic locality but about the very nature of industrial units to be set up, the reasons and factors that would make it successful, the means to make it successful in the long run (financial support, political support, continued supply of raw material, etc), and the particular timing of its phase wise development (initiation, economies of scale, maturity and renaissance). SMIL industrial cluster in Sweden and Silicon Valley are two examples of successful clusters with very clear vision. For example, in the case of SMIL, the vision was very clear from the start that the cluster will be exclusively based on small level technology based firms¹⁴.

Addressing the private sector requirements and concerns

From the point of view of an industrialist (local or foreign), the decision to locate an industry in a specific place has to be justified. A businessman or industrialist makes a comparative analysis between the costs (production, freight, labour, etc) and advantages (monetary or otherwise) of being at a certain place, and will only locate his production plant if he finds the advantages to be more than costs. In this regard, government can always play a helping role by addressing the concern of the industrialist.

The presence of a leading actor within Economic Zones

The presence of leading actors can act as a catalyst for other, smaller level firms who can take advantage of its presence. This leading actor could be a large level firm¹⁵, whose presence in the market is substantial enough to garner opportunities in terms of demand, financing their own start-ups, incubation activities, cost and capacity sharing and other positive externalities from its sharing (like research). Semiconductor clusters in Scotland and IT clusters in Sweden (which benefitted from presence of bigger firms like Erickson and Nokia) are examples of this type of a leading actor.

Proximity of zones to research institutes

This is usually not a primary consideration when it comes to establishing EZs industrial clusters. But research¹⁶ suggests that the proximity of a good research institute to an industrial cluster could bring benefits in the form of linkages between higher education and businesses/industries. The prime example in this regard is the Silicon Valley, which is situated near to some of the most top class research universities in the world. There is close coordination between the Silicon Valley firms and the universities. Firms take advantage of the availability of top of the line research facilities, and researchers have an incentive in the form of monetary rewards. This concept is closely related to a 'network effect' and 'knowledge integration' that describes the importance of having a strong network of information.

¹⁴ Klofsten and Jones-Evans (1996),

¹⁵ Ecotec (2001), 'A practical guide to cluster development'.

¹⁶ For example, see Etzkowitz and Leydesdorff (2000), 'The dynamics of innovation: from National Systems and "Mode 2" to a triple Helix of university-industry-government relations'.

Linkages to national and international market

Every geographical locality, country and market has something to offer in terms of human resources, raw material, demand, market size, variable skills and technology. The producers, service providers or actors inside a zone cannot isolate themselves. They have to have access to this kind of national and international information that can help them orient their priorities and tasks, and help in expanding the market for their products. Demand analysis is particularly important in this regard, which can help tailor the products accordingly.

Economic Zones in Pakistan

The concept of industrial estate is not new to Pakistan. Among the developing countries, Pakistan was one of the first to embrace the idea of industrial estates. Sindh Industrial Trading Estate (SITE), Karachi, spread over an area of 4,250 Acres was established in 1947. It is the oldest Large Industrial Estate of Pakistan. By 1965, there were 3 Large Industrial Estates in operation while 28 small industries were either proposed, under construction or already in operation.¹⁷ But as per the international definition of Economic Zones (stated in the beginning), the first formal Economic Zone was established in 1988¹⁸.

At present, there is an estimated 77 EZs comprising industrial estates, EPZs and FTZ's. Majority of them fall under the *general* category of EZs. A complete list of these zones is



The Ministry conducts research and prepares feasibility studies before declaring an area as an Economic Zone. The area could be identified by the ministry itself, or a politician (MPA/MNA) or in some cases the private sector businessmen.

Dr. Khalid (Section Officer, IID-II)



available at Annex-I.

In Pakistan, there are different kinds of Industrial Zones, working under different departments of federal and provincial governments. All of these, except for Sindh SEZ, are of general EZ type.

¹⁷ Gloeckner, Peter H , Industrial Estates : an instrument for industrial development and promotion (Lahore: Ferozsons, 1966)

¹⁸ 'SEZs: Performance, Lessons Learned and Implication for Zone Development', FIAS (2008).

Table 4: Types of Industrial Zones in Pakistan

Authority	Organizations	Type Industrial Zone
Federal	Ministry of Industries	Export Processing Zones & SEZs
	Export Processing Zone Authority	EPZs
	National Industrial Parks	Industrial Parks and SEZs
	Capital Development Authority	Islamabad Industrial Estate
	SMEDA	Industrial Clusters
Punjab	Punjab Industrial Estates, Development and Management Authority	Industrial Estates
Sindh	Sindh BOI, Special Economic Zone Authority (SEZA)	SEZs in Sindh
	Sindh Industrial and Trading Estates Ltd	Industrial Estates
KPK	Sarhad Development Authority	Industrial Estates
Baluchistan	Directorate, Industries and Commerce	Industrial Estates

Source: Compiled by author through different sources.

Compared to the relatively outstanding performance of EZs and SEZs in other countries, especially China, their performance in Pakistan has remained subpar. This is reflected in the following graphs, which indicates a dismal performance in terms of revenue earned through EZs and the poor performance of Pakistan’s EZs in fiscal 2014.



Figure 1: Export Performance of Export Processing Zones in Pakistan (Source: Ministry of Industries, Yearbook)

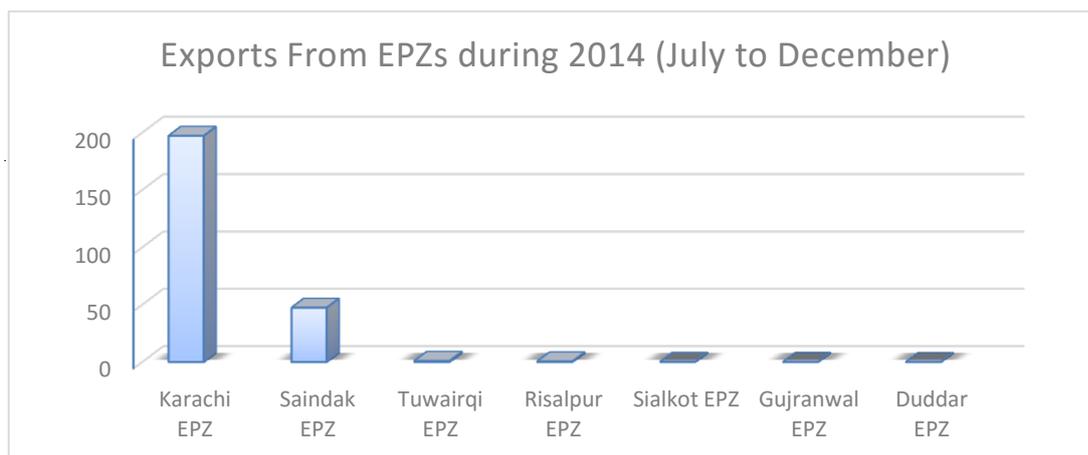


Figure 2: Exports from all EPZs during 2014 (US Million \$) (Source: Ministry of Industries, Yearbook)

This specific aspect of policymaking in Pakistan has suffered from the following causes, with major portion concentrated on the failure of zone development in KPK as a case in study.

Inconsistent policies of the Government

The example of Hattar Industrial estate in KPK will show the consequences of inconsistent policies. The Federal Government in 1988 provided some incentives for encouraging industrial investment in KPK, including Income Tax holidays for 8 years, sales tax exemption for 5 years, duty free import of raw material, 50 percent concession in electricity tariff, provision of loan at 3% markup, and exemption from custom duty and machinery.

The above incentives stimulated the pace of Industrial Development in the province, resulting in establishment of 192 industrial units in Hatter Estate, with a total investment of Rs. 18.798 billion and employment- opportunities for about 17,522 workers. Similarly, 228 units were established in Gadoon Amazai Industrial Estate, with a total investment of Rs. 9.123 billion and employment provided to about 16,762 workers¹⁹.

¹⁹ "CAUSES OF INDUSTRIAL FAILURE AND ITS IMPLICATIONS IN NWFP", Quarterly SCIENCE VISION Vol.8(3&4) January - June, 2003

But these incentives were pre-maturely withdrawn by the Government during the period 1991-95. As a result, industrial units started closing down and, presently, 1145 units out of 1848 are lying closed. The premature withdrawal of such concessions aside, this aspect clearly points to the over-reliance of private sector on government favors (like tax concessions) in terms of successful workings of an EZ. There is noticeable lack of any private sector led initiative in with an aim to be less reliant on the government. This is especially disconcerting since the successful zones world over are largely a hybrid model of joint



Premature withdrawal of incentives and inconsistent government policies led to closure of 1145 units out of 1848 in 2002-03.

“CAUSES OF INDUSTRIAL FAILURE AND ITS IMPLICATIONS IN NWFP”, Quarterly SCIENCE VISION Vol.8 (3&4)



government-private sector efforts. Government’s role is mainly that of a facilitator.

Location disadvantage and lack of proper infrastructure

In terms of successful operations of an economic zone, one of the most critical aspects is its location advantage. These come in various forms like proximity to a resource (mine, dry port, and airport), major market for consumers and research and development institutes (for example, a university)²⁰. But as the following table illustrates, most industrial zones in KPK are located far off from major markets, airports or dry ports, which confer a substantial disadvantage upon them. Besides demonstrating a location disadvantage, it also points to poor planning for setting up these industrial zones. Also the Head offices of DFI/Banks are mostly in Karachi or bigger cities of the country, thereby making the access to these institutions either impossible or costly. Moreover, the distance from the airport, (in few cases, distance from Dry Port) somehow explains the number of closed units in an industrial estate according to its proximity to big cities.

Table 5: Status of Industrial Estates in KP

Name	Installments	Operational	Closed Units	Distance to Peshawar
Peshawar	324	212	43	04km (15 Mins)
Gadoon Amazai	321	98	124	120km (2 Hrs)
Hattar	440	230	119	142km (2 Hr 30 Mins)
Nowshera	66	40	3	12km (30 Mins)

²⁰ Another example of lack of infrastructure is absence of land for showcasing the products of firms within an EZ. For example a major setback of Hattar Industrial Estate is a lack of Display market despite being promised for many years. (Interview with Chairman Business and Research Committee, Hattar Industrial Estate)

Source: www.sda.org.pk²¹

In contrast, the I-9, I-10 industrial area in Islamabad represents a case of relatively success story primarily due to its location in the vicinity of Rawalpindi and Islamabad which represent a major consumer market²². Plus, these industrial units are also close to go-downs or storage facilities. This gives them an advantage in terms of their operations.

Law and order situation

Due to Afghan war and the present war on terror, KPK particularly suffered substantially in terms of law and order. This has badly shaken the investors' confidence, making them reluctant to invest. Industries reliant on imported raw materials from Afghanistan were particularly affected. Besides KPK, the mega city of Karachi is also a clear reflection of this connection between law & order and industrial growth. The adverse situation there also prompted a decline in industrial performance.

Improper Selection of Industry

Success of the industries depends on the proper selection of products and proper scanning of the market. Most of the industrialists selected their industry either on incentive based strategy (incentive offered by the government on startup of a specific industry) or mushroom growth of a similar industry.

Non-specialization of Labour leads to lower employment

Beyond a certain number of industrial establishments, the returns in terms of additional employment begins to decline. The graph presented below depicts that as the mixture of industries increase in an EZ, the resultant employment generated declines which implies declining returns in the form of additional employment through additional units of production. This is in contrast to international norms, where the expansion of SEZs is accompanied by additional hiring of labour.

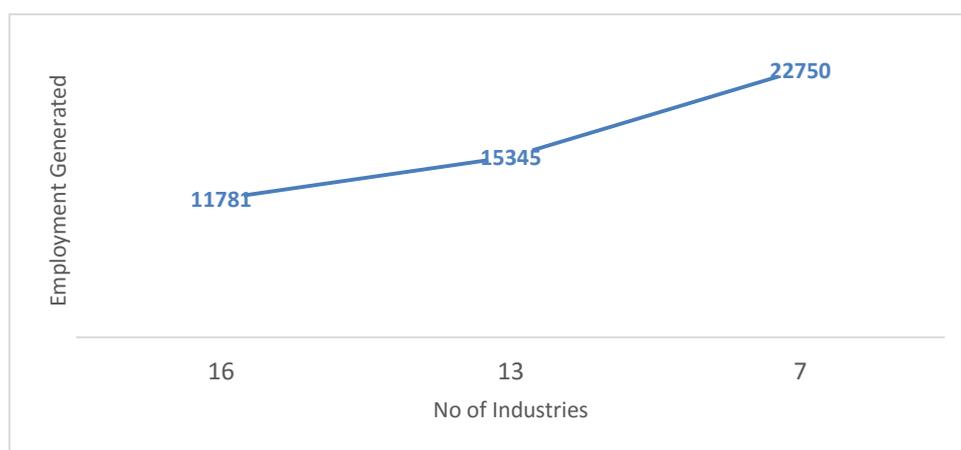


Figure 3: Types of Industries and Employment Generation

²¹ Table compiled on the basis of data available at www.sda.org.pk

²² Background interview with an Industrialist in I-9 industrial area.

Cost of Development is higher than Economic Gain

As of 2001, the total government expenditure spent on developing three industrial estates since 1973 (Peshawar, Hattar, and Gadoon Amazai) were greater than its economic benefits. This is reflected in the following table.

Table 6: Economic Costs and Benefits of Industrial Estates

Description	(RS. MILLION)
Contribution to GNP (CUSTOMS DUTY, SALES TAX INCOME TAX)	5,614.691
Revenue to WAPDA, SUI GAS, PTCL.	1800.391
Direct Jobs Created in Industries	112.708
Indirect Jobs	486.915
Transport Sector	1,674.062
Export Earnings	5,614.680
Total Economic Benefits	15,303.45
Provincial Govt. Expenditure	15,414.725

Source: www.sda.org.pk

Clearly, the cost of planning, implementing and administering an EZ has implied additional fiscal expenditures for the provincial government of KPK. Although data is not available, but it can be safely assumed that the same situation prevails in other provinces and at the federal level too. This all implies that this is not a fiscally feasible option for various tiers of government. They would probably be better off in supporting the development of EZs rather than directly supervising and intervening in its running.

The above were the major reasons for the relatively subpar performance of the industrial EZs in Pakistan. What follows is an example of a private led successful initiative in the form of Chunian Industrial Estate, an initiative that is rare in Pakistan.



Chunian Industrial Estate is a classic example of successful industrial estate. The project was initiated through the efforts of some industrialists which then turned into an industrial estate. This is a nonconventional industrial colonization where neither land was acquired, nor were plots demarcated by any public agency. Area within two kilometres on either side of Multan Road in Tehsil Chunian was declared as industrial area with incentives package including 100 percent exemption of customs duty on plant and machinery and Tax Holiday for four years which was further extended to five years under Rural Industrialization Policy. These incentives, however, were withdrawn in some later years. Reasons for the success of the Chunian Industrial Estate are proximity to Lahore, fiscal and monetary incentives, favourable investment climate, and law and order situation in Karachi which resulted in diversion of investment from Karachi to Punjab. Cotton related industry got special incentives in this region because of cotton producing agriculture land.

Economic Freedom in Pakistan, Sub National Index 2009



Inconsistent Tax policies

In declaring the EZs as tax free zones, it is counter intuitive to levy a tax on them at the same time. Also consider the fact that a presumptive tax, by definition, is an advanced tax on future production. In essence, what happens is that the incentive in the form of tax free zones is cancelled to a large extent by the imposition of a presumptive tax on production. This reflects contradictory policies on the part of policy makers and planners.²³

Implementation

Adding to these the weaknesses in implementation phase of EZs in Pakistan is another huge challenge. For example a concise feasibility study of Khairpur EZ has already been prepared but the challenge lies in its implementation and avoiding contradictory policies like presumptive taxes.

²³ Ministry of Industries, Year Book 2013-14



Hattar Industrial Estate lacks basic infrastructure like a proper display market for products, a railway container terminal (despite being in vicinity to a railway track), poor road conditions and unplanned location of industrial units within the estate, thus increasing the cost of business.

Chairman Business and Research Committee, Hattar Industrial Estate



What's in it for Pakistani businessmen?

The need of a private sector led Economic Zone

Industrialists and businessmen face a plethora of problems when it comes to investing, establishing, operating, owning and further developing an industrial estate or an EZ in Pakistan. Some of the major problems have been mentioned above. Global rankings (like those of Global Competitiveness Index²⁴) testify to this fact. EZs, to say the least, offer a way around these problems. The very concept of establishing an EZ is to establish a preferential area where the problems normally encountered by a country's business community are taken care of. In short, the transaction costs of being in an EZ, complemented by positive spillovers of various forms, outweigh the costs outside of it. This constitutes the main attraction for the business community within a country.

The universal success of EZs offers a lesson to Pakistani businessmen and policy makers alike. But in failing to pool their efforts together for the purpose of establishing and running an EZ, business community in Pakistan has become too reliant on government in this regard. This goes against the increasing norm of government acting only as a provisioner of critical resources and the private sector taking the lead in running the affairs of EZs. Sundar industrial estate offers an exception, but these kinds of initiatives are few. The need is for the private sector to take lead, pool their ideas and resources together for the establishment of EZs in Pakistan. They serve not only as conducive environments for conducting business, but also as breeding grounds for new, creative and value added products through newer ideas.

Proposed future course of action

For any future course of action regarding the development of EZs in Pakistan, the recommendations made in the above section titled 'What makes an economic zone

²⁴ Among the 140 countries that are ranked according to this index, Pakistan lies at a poor 126.

successful' must be kept in perspective. Besides those recommendations, the following represent salient suggestions in this regard;

a) State level policy and EZ operations in Pakistan till date are mostly a reflection of the *static* form of EZ development. Emphasis in Pakistan has primarily been upon physical demarcation of land and awaiting interested parties to show their interest. Little emphasis is placed upon other drivers of expansion and development, a strategy which needs to change. Any future strategy must take the *dynamic* form of EZ development into perspective since it marks a transformation from lower, less value added production to product sophistication through technological application.

b) One of the most distinguishing features of EZ development in Pakistan is almost the non-existence of privately led initiatives that is fast becoming a norm around the world. Studies tend to disregard the fact that government led efforts normally entail a continuing and incremental cost of operating these zones, which are non-recoverable (sunk costs)²⁵. Punjab Industrial Estates Management Company (PIE) has led the way in moving away from government dependent EZs and industrial clusters towards privately managed estates where the government only plays a supportive role. Its strategy has been comparatively successful, and has paved the way for opening new industrial zones in Punjab without government funding²⁶.

c) Utilize already established EZs where capacity lies idle. Many countries have successfully transformed their idle EZs into SEZs, and have reaped the rewards for it²⁷. Establishing new EZs require substantial infusion of capital, therefore it would not be a bad idea to analyze the prospects of utilizing any idle capacity in already existing zones²⁸.

d) For future, more emphasis should be placed on developing national and international linkages, technology transfers, skill development, strong linkages between academia and industry, and increased private sector led development of economic zones where the government plays the role of a facilitator. Recent trends tied to the increase in private zone development include the development of SEZs and industrial estates on an integrated rather than stand-alone basis, increased specialization of facilities catering to the unique needs of target industries (hi-tech, petro-chemical, software, among others) and the provision of a greater range of business support services and specialized facilities. Many of these "next generation" zones cater to higher value-added industries and are able to charge premium rates.

²⁵ "SEZs: Performance, Lessons Learned and Implications for Zone Development", FIAS (2008), p.33.

²⁶ 'Punjab way ahead in industrial development', the NEWS, 8th October 2015.

²⁷ India passed its SEZ Act in 2005. It revitalized/utilized the existing EZs and their idle capacity to transform them into SEZs. In 2006-07 alone, the exports of products from within these SEZs comprised a total of \$5 billion (besides realizing substantial domestic and foreign investment and job creation).

²⁸ For example Pakistan is planning to build new Economic Zones along CPEC route, see Annex-II for detail.

Conclusion

Overall, EZs have been a tremendous success around the globe. Their phenomenal growth in numbers, especially since 1970's, is a testament to their success. But they have not become successful just by the act of establishing them. Rather, there are a host of factors at work which made them such a success. One of these factors is the advent of new ideas, products and continued innovation, which led to the evolution of SEZs from EZs. Industrial and technological clusters like Shenzhen (China) and Silicon Valley (USA) are a reflection of this evolution.

Yet, in Pakistan, the development of EZs has been rudimentary. The kind of dynamism associated with success stories like SMIL and Silicon Valley are non-existent, and the operations of these zones are heavily tilted in favour of exports. There has been little evolution towards SEZs. And there is a pronounced absence of the private sector led initiatives in this regard. If Pakistan's EZs have to realize genuine success and long term viability, then there is no substitute for dynamism in their operations and private sector led initiatives. Only this will ensure a positive outcome.

Annexure I

Authority	Type	Location	Name
Federal	Industrial Estate	Islamabad	Islamabad Industrial Estate
Punjab	Industrial Estate		Quaid-e-Azam Industrial Estate
			Sundar Industrial Estate
			Multan Industrial Estate
			Bhalwal Industrial Estate
			Rahim Yar Khan Industrial Estate
			Vehari Industrial Estate
Sindh			SITE Karachi
			SITE Super Highway
			SITE Nooriabad
			SITE Kotri
			SITE Hyderabad
			SITE Tando Adam
			SITE Nawabshah
			SITE Sukkur
Baluchistan			Quetta Industrial and Trading Estate
			Industrial Estate at Dera Murad Jamali.
			Lasbela Industrial Estate.
			Hub Industrial and Trading Estate
			Gwadar Industrial Estate.
			Marble City Gaddani.
			Winder Industrial Estate.
			Mini Industrial Estate Loralai.
			Mini Industrial Estate Khuzdar.
			Mini Industrial Estate Bostan.
			Mini Industrial Estate Kalat.
KPK			Industrial Estate Peshawar
			Industrial Estate Gadoon Amazai
			Industrial Estate Hattar
			Industrial Estate Nowshera
			Industrial Estate D.I.Khan
			Industrial Estate Jalozai
Federal	Clusters	Sargodha	Agricultural Implements
		M.B.Din	Auto Body Parts
		Lahore	Auto Parts
		Multan	Bed Wear
		Gujranwala	Ceramics
		Chao Sadan Shah Chakwal	Coal Mines
		r y khan	cotton ginning
		R.Y.Khan	Cotton Seed Processing
		Sargodha	Crankshaft
		Gakkhar Gujranwala	Darri
		Muzaffargarh	Dates Cluster
		Sargodha	Electrical Fittings
		Gujranwala	Fan Cluster
		Lahore	Foundry
		Gujrat	Foundry Cluster
		Gujranwala	Gas Appliances
		Gujranwala	Home Appliances
		Sargodha	Kino Processing
		Faisalabad	Light Engineering
		Gujranwala	Light Engineering

		Multan	Mango Growers
		Lahore	Meat Processing
		Okara	Potato
		Faisalabad	Power Looms
		Hafizabad	Power Looms
		Jalapur Jattan	Power Looms
		Mandi Bahauddin	Rice Husking
		Sialkot	Sports Goods
		Gujrat	Wooden Furniture
		Rawalpindi	Wooden Furniture
Federal	Clusters	Karak	Honey Cluster
		Turnab	Honey Cluster
	Export Processing Zone-EPZ	Karachi	Karachi Export processing Zone
		Saindak	Saindak Export Processing Zone
		Risalpur	Risalpur Export Processing Zone
		Sialkot	Sialkot Export Processing Zone
		Duddar	Duddar Export Processing Zone
		Tuwairqi	Tuwairqi Steel Mills Ltd EPZ
		Gujranwala	Gujranwala EPZ
		Gwadar	Gwadar EPZ
	Industrial Parks- IP	Karachi	Korangi Creek Industrial Park
			Bin Qasim Industrial Park
		Lahore	Rachna Industrial Park
	IP- <i>in progress</i>		Gems & Jewelry Manufacturing Centers
	SEZ- <i>in progress</i>		Khairpur Special Economic Zone
	IP- <i>in progress</i>		Marble City Risalpur

Annexure II

Khyber Pakhtunkhwa
Marble and Granite based Industrial Estate at Mansehra – 80 acres. Industrial Estate Nowshera Expansion of Industrial Estate Hattar Industrial Estate at Chitral Industrial Estate Ghazi Industrial Estate D. I. Khan
Punjab
<u>Existing/Under Development</u> Multan Industrial Estate Phase-II Rahim Yar Khan Industrial Estate Bhalwal Industrial Estate
<u>Possible Future Industrial Estates</u> DG Khan Industrial Estate Mianwali Industrial Estate Rawalpindi Industrial Estate PD Khan Industrial City
Gilgit-Baltistan
Moqpondass District in Gilgit
Baluchistan
Industrial estate in Gwadar Lasbella Industrial Estate Turbat Industrial & Trading Estate Dera Murad Jjamali Industrial & trading Estate Winder Industrial & Trading Estate (WITE) Mini Industrial Estate Khuzdar
Sindh
Chinese Industrial Zone near Karachi Textile city, Port Qasim Karachi Marble City, Karachi Korangi Creek Industrial Park, Karachi Bin Qasim Industrial Park Khairpur Special Economic Zone

Source: Board of Investment