

POLITICAL ECONOMY OF SPECIAL ECONOMIC ZONES UNDER CPEC IN PAKISTAN: PROSPECTS AND CHALLENGES

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ABSTRACT

Many economic experts consider the establishment of Special Economic Zones (SEZs) a vehicle to rapid industrial growth in developing countries. In the age of connecting economies, most of the developed countries of the world are following the approach of SEZs to achieve the goals of sustainable development. However, the results of SEZs vary from country to country due to their respective political, administrative and regulatory policies. Basically, the SEZs are special delimited areas, mostly located in the vicinity of the border areas, wherein the business rules are kept relaxed as compared to the rest of the country to attract the foreign as well as local investment. Pakistan intends to establish around 40 SEZs under the mega project of CPEC. The State seems to be committed in introducing administrative, political and economic reforms to provide the conducive environment for the business activities in these zones. The impetus behind the establishment of the SEZs is that these zones would accelerate the process of industrialization, create job opportunities for Pakistanis, attract Foreign Direct Investment, increase the volume of export and consequently enhance the economic growth of the country. This paper will critically analyze the following research questions: How the establishment of SEZs under CPEC is crucial for the economic development of Pakistan? What is the expected role of state to make these SEZs a success story? What challenges and risks are involved in establishing the SEZs in Pakistan?

Keywords: Pakistan, SEZs, CPEC, Development, Administrative, Political, economic.

Introduction

In the modern era of connecting economies industrial zones are gained popularity all over the world. Most of the countries [no matter what political system they have (either socialist or democratic)] are exploring new possibilities of trade and economic growth through establishing SEZs without altering their overall political and administrative structures. For instance, China is a socialist country and holds a totalitarian political system but at the same time it is running SEZs (which demand little of state and liberal economic environment within their defined area)

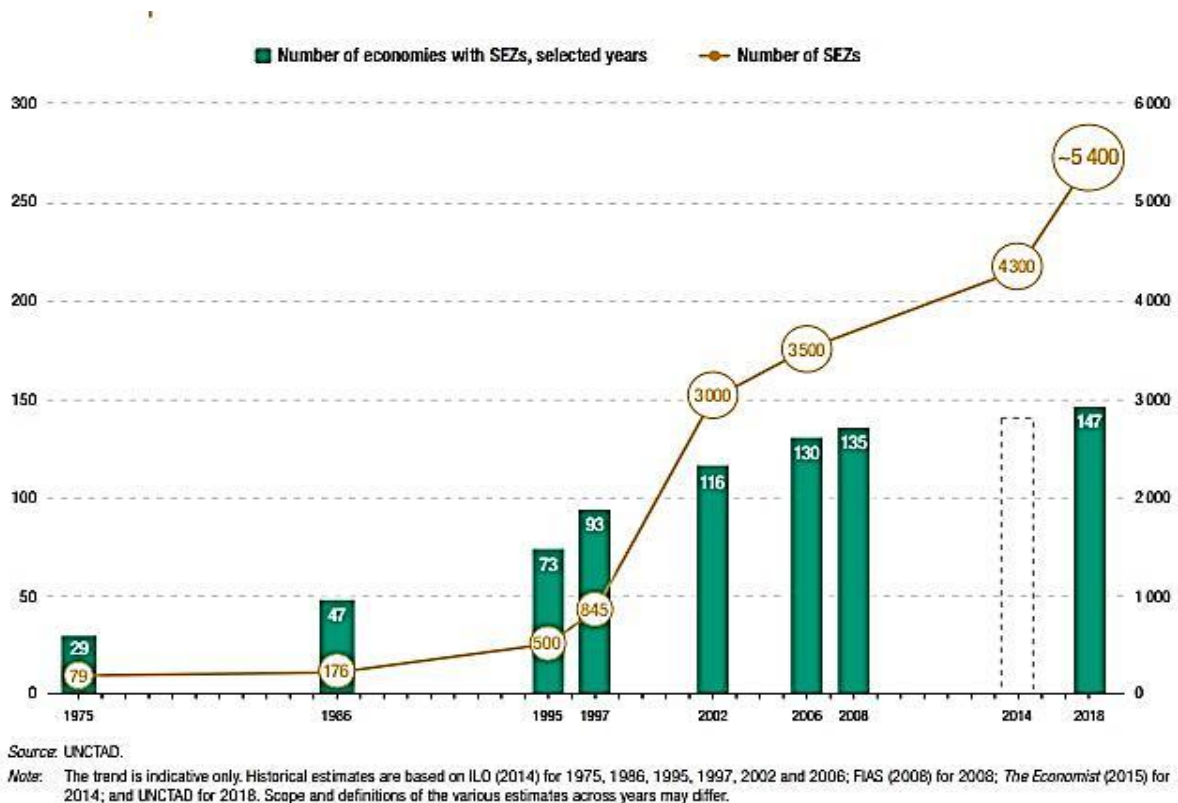
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successfully. Actually, SEZs are special delimited areas which are mostly located in the vicinity of the border areas. These geographic areas are different from the rest of the state in respect of the rules regarding business and investment. The main reason behind this is to promote the investment and employment opportunities in the zones. It is considered that it has positive effect on overall economic growth and development of a state. In a report issued by World Bank in 2008, SEZs are defined in these words, “SEZs are generally defined as geographically delimited areas administered by a single body, offering certain incentives (generally duty-free importing and streamlined customs procedures, for instance) to business which physically locate within the zone.” (Akinci & Crittle, 2008) The table below describes the historical trends of developing SEZs in world and also describes the increasing number of countries with increasing number of SEZs within selected years.



The available literature on SEZs show that different countries have experienced the different economic results by establishing SEZs in their respective countries. Some scholars consider it conducive for a particular group of businessmen because it benefits few and also distort the resource allocation. Some view it as limited success for a limited time span and some are concerned about the development of SEZs' enclaves which will ultimately confine the welfare.

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On the other side, many scholars think that overall social welfare will be increased through SEZs because they increase FDI and enhance export diversification. This attraction will be resulted in the greater number of jobs in particular area and demonstrate a positive cost-benefit effects, which are quite evident in East Asian states' experiments. Moreover, the establishment of the SEZs is aimed at the concept that it will surely have a positive spillover effect which can affect the local markets and concerned markets of the region. It may also affect the trends of labor markets and welfare of the local economy. However, this research article deals with the importance of Special economic Zone under CPEC project in Pakistan.

Current Status of SEZs in Pakistan

Like other developing countries, Pakistan is a semi-industrial country with low economic growth. Under the umbrella project of China- Pakistan Economic Corridor (CPEC) Pakistan has taken a strong initiative to establish SEZs to speed up its socio-economic growth. Almost 40 SEZs are expected to setup across the country (the feasibility report has been shared with China for further process). Currently, three SEZs namely Dhabeji, Rashakai and Faisalabad are functional and further four (Bostan, Mirpur, Mohmand and Moqpondass) are under process.

The SEZ of Gwadar was first model in Pakistan covering the area of 3000 acres on special discretion of China. Gwadar port is quite significant for China because 60% of its oil is coming from the Persian Gulf and Gwadar reduce the distance of 16000 km (of old routes) to mere 5000 km (). It not only shortens the distance but also reduces the dangers of confronting pirates, political rivals, changing weather conditions and time consumption. Almost 80% of its cost is provided by China and over 500 Chinese workers came to setup the port. The first phase of CPEC is characterizes with the establishment of physical infrastructure and transfer of technology and skill in Pakistan. It helped to increase employment opportunities, connectivity between local and foreign firms, rising exports and higher FDI in Pakistan. Urban development, transformation of a fishing village into a mega industrial city and Human Resource Development is also evident in Gwadar SEZ. After the success story of Gwadar Pakistan has been entered into the second phase of SEZs' development.

Thus, Pakistan is offering many fiscal and general incentives to its SEZs to make possible the ease of doing business within the zones. In this regard, one-time exemption from all custom, duties & taxes will be awarded for all capital goods that will be imported for the operation, development and maintenance of SEZ for the period of five years. In addition, one-Window operation and dry-port facility is provided in the Zones. Some general incentives of SEZs are provision of electricity, gas and all necessary utilities, and Permissible Captive Power Generations. Gwadar the first model of SEZ in Pakistan offered certain tax facilities to the investors and entrepreneurs. The facilities in Gwadar are: tax exemptions of 23 years on gains

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and profits from business setup in Gwadar, same as for the Chinese companies working in Gwadar, tax exemption of for 20 years for the contractors and sub-contractors of specified Chinese companies and further the sales tax, excise duties and with-holding tax are provided to both local and Chinese investors. It is ensured that in all the SEZs under CPEC, similar facilities will be provided to make the zones successful.

SEZs: Benefits for Domestic Economy of Pakistan

Douglas Zhihua Zeng is a senior economist with trade and competitiveness Global Practice at the World Bank Group. In his study on SEZs he considers that if the implementation of SEZs is carefully administered and planned then it can be beneficial for population in two ways. First in direct way which is known as 'static benefits' and the second one is indirect way or 'Dynamic benefits' of SEZs. He includes employment generation, foreign exchange earnings, foreign direct investments, government revenues and export growth in direct and static benefits of the SEZs. While, the dynamic and indirect benefits of SEZs include the skill up-gradation, testing field for wider economic reform and demonstration effect, technology transfer, innovation and adoption of modern management practice, export diversification, enhancing trade efficiency of domestic firms, cluster facilitation, urban and regional development and even green growth and productivity enhancement of local firms. (Zeng, 2010). He emphasized that the static benefits ultimately lead toward the indirect or dynamic effects of the SEZs. These effects can vary from country to country or SEZs because such special zones contribute in the overall performance of the economic development but the specified or targeted areas may not be well promoted or gain success as per desired. The ultimate reason behind this is the changing nature of the political and administrative structures of the countries and it is also possible that the effects may not have spillover effects on the local producers. Further the direct effects of SEZs defined by Zeng are easier to achieve and the indirect effects are conditioned with the success of the SEZs. A report prepared by the UN connotes that, 'bilateral partnerships building zones in developing countries, many new innovative zones are emerging, international co-operation is increasing on zone development and many new programs beyond trade, like high-tech, financial services or tourism being promoted through this.' (UNCTAD, 2019)

In the case of Pakistan, the static benefits of SEZs include industrialization, employment generation, establishment of new firms in SEZs (that have linkages to the domestic markets so that their investors can buy factors of production from domestic sources), higher volume of exports and FDI and accumulation of certain industries which is known as Cluster development. As far as the dynamic effects are concerned, infrastructure, joint ventures (the interaction of foreign firms with domestic firms), technological up-gradation (the spread of knowledge from foreign corporations to domestic business) Human Resource Development (HRD- competitive environment leads to skill development), Urban development and Competitive Private Sectors

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are included. China and Pakistan set some priority industries under CPEC to work for industrial co-operation; these are iron and steel, mines and minerals, textile, petrochemicals and agriculture. All of these sectors spread the chain of SEZs in all the provinces of Pakistan. In the case of Pakistan, the main objectives behind the creation of SEZs are creating employment opportunities, sustainable but growing GDP, to improve the volume of exports and to attract FDI. Studies about performance of CPEC clarifies that, in 2013 Pakistan was facing acute energy crisis of electricity. The condition of transport network was also crumbling. After the implementation of CPEC, situations are changed for better. Under the first phase of CPEC, load shedding reduced a lot and the transportation infrastructure is also improved considerably through integrated road networks and up-gradation of railways.

The role of State in facilitating and governing the SEZs

The mass adoption of SEZs in the global market is continuously changing the nature of policies regarding their functioning within territorial limits of SEZs. This is the reason that different states opted for different patterns/models regarding functioning of SEZs. Usually, the state limits its right to control economic activities and economic actors in territorial limits of SEZs but they are not completely free from the influence of state because some form or degree of administrative governance is necessary to manage the mechanisms/operations of these zones.

Further, there are certain regulations, laws, political and administrative reforms and their proper enforcement are required to develop a successful SEZs in a country and only State has this prerogative to do so. As for as Pakistan is concerned, it passed SEZs Act in 2012 under CPEC (later it was amended in 2016) to attract the foreign as well as local investors to invest in these Zones. Pakistan adopted three modes to develop SEZs: development through Public sector; development through private sector and; development through public-private partnership (for that purpose corporate governance rules were introduced in SEZs Act). In addition, to make the overall economic environment investment friendly, it implemented more than 300 reforms in different laws and regulations since 2016 and improved her rank in “Ease of Doing Business index” 39 times during last two years (from 147 to 108 out of 190 countries). (BOI, 2020). Construction permits, procedure of property registration, paying of tax system and access to get connection of commercial, registration of any company in Securities and Exchange Commission of Pakistan etc. (see the table below for details) have been easier in Pakistan.

Table:1 Six Regulatory Reforms to Improve the Business Climate in Pakistan

Ease of doing business measures	Reforms
Starting a business made easier	Company can now be registered in one day with *SECP& **FBR. Data is transferred to Labour Dept, ***PESSI, ****SESSI and *****EOBI in real time. Only SECP portal is used. End to End integration of 9 departments has been made.

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Registering property made easier	Commercial property can now be registered in 22 days in Lahore and 149 days in Karachi instead of 25 and 208 days previously.
Construction permits made easier	Getting construction permits now takes 108 days in Lahore and 134 days in Karachi as opposed to 266 and 261 days originally.
Paying taxes made easier	Online payment of Taxes has been introduced. The numbers of payments are now measured at 34 from 47 and time for paying taxes has reduced substantially. Tax rates for small companies reduced from 25% to 2 4%
Getting electricity made easier	Commercial electricity connection can now be obtained in 73 days in Lahore and 134 days in Karachi as opposed to 117 and 185 days in previous report. Online portals of LESCO and K-Electric have been launched. Tariff changes are announced in advance.
Trading across borders made easier	*****WEBOC Customs software has reduced time to export for border compliance from 75 hours to 58 hours and time for Imports for documentary compliance from 143 hours to 96 hours

Source: <https://invest.gov.pk/eodb>. (Data is derived from the website of Board of Investment)

*Security and Exchange Commission of Pakistan

**Federal Board of Revenue

***Punjab Employees Social Security Institution

****Sindh Employees Social Security Institution

*****Employed Old Age Benefits

*****Web-Based One Customs

In Pakistan, the minimum required land to establish an SEZ is 50 acres (there is no limit for maximum land) and Board of Investment works as secretariate for SEZ. Further, in previous zones (industrial clusters, free trade zones and industrial estates etc.) the focus of investment policy was confined to manufacturing sector only. While, SEZs under CPEC are opened for more sectors including service sector i.e. information technology and its enabled services (IT & ITES), Textile, Agriculture and food processing, Logistics, Tourism and housing and construction. On 16th September 2020, Atif Bukhari (Chairman BOI) announced that Government is going to launch the Electronic Vehicle Policy and Mobile Manufacturing Policy soon (see BOI website for detail).

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Moreover, Current Government has brought some important administrative reforms to make successful the SEZs under CPEC. For example, the area of influence of BOI has been expanded and its orientation is being reformed as well. The promotion of economic growth in SEZs through attracting the foreign and local investor has become the sole responsibility of the BOI and for that purpose BOI is aimed to adopt sale-oriented organizational culture (BOI, 2020). Actually, the sale focused organizations try to seek excellence in its all departments from production to services because if they don't do so they can quickly lose their sale due to customer's dissatisfaction (in this equation, investors would be treated as customers). According to business experts, the benefits of sale-oriented culture last for long-term because it is not only aimed to achieve success but it is more focused on to maintain the status along with new achievements. (Harrison, 2016, Vistage). In addition, online services have been introduced in Federal Board of Revenue, Custom and Sales tax departments to reduce regulatory constraints and enhance transparency in the business regime. The regulations of Securities and Exchange Commission are also amended to make the procedure of the registration of companies more transparent. Currently, more positive administrative changes are expected in financial and security sectors of Pakistan after the passing of Anti Money-laundering, Anti- Terrorism, Waqf properties bills under the umbrella of FATF Bill. Government officials are hopeful that after this legislation Pakistan would be successful to resolve the reservations of foreign investors regarding law and order situation and legal system.

In last, government of Pakistan has also amended the local government system through local government bill in 2019. It is expected that the new system (whenever the bill implemented) will promote the culture of openness, transparency and access to information to make the local institutions more vibrant and effective to administer the SEZs efficiently.

The Impact of SEZs on Economy of Pakistan

After the establishment of SEZs under CPEC, several developments have been observed in Pakistan. In 2013, it is expected that the business of motor-vehicle assembling, cement and insurance will be flourished more. The following table describes the growth of these business sectors after the initiation of SEZs.

Table:2 Impact of SEZs under CPEC on Different Business Sectors of Pakistan

Analysis of growth in different business sectors after CPEC and SEZs					
Year	Chinese Companies in Pakistan	Karachi Stock Exchange Index	Share Price in Motor Vehicle Assembling	Share Price in Cement Company	Share Price in Insurance Sector
2013	373	Below 20,000	Below 200	Almost 200	Almost 100
2014	445	Below 30,000	Below 800	Almost 500	Above 400

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2015	535	Almost 35,000	Almost 1000	Below 500	Almost 500
2016	775	35,000 to 45,000	Almost 1800	Above 800	Above 500
2017	-----	46,565	Almost 1800	Almost 800	Above 800

Source:www.psx.com.pk

Many experts had predicted that soon after the initiation of CPEC, some industrial sectors would experience a rapid boom in Pakistan. These sectors include the automobiles' assembling, cement and insurance companies. The indexes of PSX show the level of development in these sectors. PSX (formerly known as KSE-100) showed a rise of 125% in a period of only four years. The share prices of motor-vehicles' assembling companies witness the rise from 2.6 times to 11 times. The share prices of cement companies leap from 2.6 times to 4 times, and the development of insurance companies is also jumped up from 2.2 times to 9 times in the same period of 2013–2017.

Further, the regulatory reforms in six major sectors (see Table:1) have been improved the business environment in Pakistan. The facility of one-stop-shop has made easier to start a business and this feature of our economy has become attraction for FDI. In addition, labor department of Lahore has abolished labor registration fees to facilitate the new businesses in the SEZs. Pakistan is revising corporate governance rules to protect the minority investors indicators through reducing the undue control of board in decision making for the safeguard of minority stakeholders 'rights (Pakistan is included in top thirty economies on this measure). However, Pakistan needs to improve its rank in 'enforcement of contracts' in which she ranked 156th with regard to ease of doing business measures. For that purpose, legal reforms are needed to resolve the commercial disputes speedily.

It is global prerequisite for the success of SEZ that a best strategic location must be optimized. A location which can provide easy trade, air or water routes for the transfer of raw materials and manufactured goods is suitable to increase the benefits. For this purpose, a careful investigation from the bureaucratic institutions is mandatory. There are some globally acceptable prerequisites for the success of special economic zones which include wider area, strategic location, effective connectivity and linkages, ease of acquisition, labor force, investment incentives, Industrial suitability, market orientation and status of environmental suitability.

Table:3 Global Prerequisite Available in Pakistan's Functional SEZs

Global Prerequisites available in Pakistan's functional SEZs		Dhabeji	Rashakai	Faisalabad
Wider Area	Acres	1000	1000	3000
Strategic Location	Approved at initial stage of CPEC	Yes	Yes	Yes
	Railways	5 Km	No	0km

Connectivity and linkages	Air	80km	50 km	66km
	Sea	85km	No	No
	Dry Port	No	65km	0km
	Motorways/Highways	5km	0km	0km
	Proximity to Market	50km	10km	25km
	Proximity to Raw Materials	100-200 km	10-150km	0-50km
Ease of Acquisition	Under_ Construction	Difficult	Easy	Difficult
Labor Force	Level of Skill	High	Low	High
	Unemployment Rate	4.92%	7.16%	5.97%
	Wage Rate (skilled)	PKR 7437.12	PKR 7738.31	PKR 13295.67
Facilities	Fresh Water	Low	High	High
	Waste Disposal	No	No	Yes
	Scientific Labs	No	Yes	Yes
Incentives	Mode of Payment	Full Payment	Installment	Installment
	Markup Discount	100% KIBOR	5%	0%
	Land Price Discount	0%	25%	0%
	Transport Subsidy	0%	25%	0%
Long-Term Planning	(2015-2030)	Yes	Yes	Yes
Industrial Suitability	Iron & Steel	Yes	No	Yes
	Mines & Minerals	No	No	No
	Textiles	Yes	Yes	Yes
	Pharmaceutical	Yes	No	Yes
	Agriculture	No	Yes	Yes
Status of Environmental Sustainability	Land Loss	Low	Medium	Low
	Air Pollution	High	Low	High
	Energy Consumption	High	Medium	High
	Water Stress	High	Low	High
Market Orientation	Export	No	Yes	Yes
	Value Up-gradation	Yes	No	Yes
	Domestic Market development	Yes	Yes	Yes

Source: developed by author data extracted from cpec.gov.pk

The expected prospects of the SEZs under CPEC are manifold and inter-connected with each other. For example, it is expected that the emergence of SEZs will create more employment opportunities in the specific areas that will ultimately help not only to develop the zone but the surroundings of the zones as well. 'Zones are often considered an effective tool for job creation, particularly for women. The impact of SEZ jobs in countries with high rates of unemployment and underemployment is significant. Especially in the poorest countries, SEZs can be an important avenue for to formal employment.' (UNCTAD, 2019). It is evident that when people have more opportunity then they will be more intended to upgrade their skills. It will increase the effects of specialization in the particular field and development will be unique. Pakistan's human

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resources are not attuned to the expected SEZ needs, neither they are proficient enough to operate Chinese technological tools and machines. This will be a major challenge for government to benefit from employment opportunity of SEZs. (Mahmood, 2018)

Pakistan has also signed a Free Trade Agreement with China under CPEC. The 75000 jobs were estimated in first phase which increased to 1 million with the initiation of second phase and helps Pakistan to alleviate poverty. The first phase of CPEC required the leading role of government but in second phase, government must be played as a facilitator role and let the private sector and business community of Pakistan to lead the project. A business community was also established in 2019 by the government of Pakistan “to establish joint working groups with the business community of other countries including China which will create an inclusive win-win ambiance for the entrepreneurs” (Obortunity, 2019). Under the second phase of Free Trade Agreement between China and Pakistan, China offered Pakistan export concession on 313 new items under which Pakistani manufacturers and traders will be able to export these items on zero duty in the Chinese market. Sheikh Amir Waheed, Chief executive officer of the AW Group of industries and former president of Islamabad Chamber of Commerce and industry said that, this transformation in FTA which includes the items from agriculture, textile goods, leather and many other ranges of goods is a positive step taken in the right direction considering Pakistan’s current financial hurdles to pay off external debt. It is a testimony to the fact that China wants to make the economy of Pakistan independent, sustainable and long-standing” (Obortunity, 2019).

There is a lot of industrial potential existing in major SEZs located in all provinces and development opportunities for a big area. Given below table depicts the shiny picture of potential industrial development in SEZs in Pakistan.

Table: 4 Potential Industrial Development in Different SEZs Under CPEC in Pakistan

Zone Name	Province and Area	Industrial Potentials	Progress Report
Rashakai Economic Zone	KPK (1000 Acres)	Fruit & Food Processing/Packaging Textile Stitching/Knitting	Concession Agreement between KPEZDMC and Chinese developer corporation has been signed in April 2019. Moreover, development agreement is at finalization stages. Groundbreaking of the SEZ is planned during the high-level visit of Chinese President to Pakistan in 2020.

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Dhabeji Special Economic Zone	Sindh (1000 Acres)	Steel Foundries Automotive/ Auto-parts Chemical & Pharmaceutical Consumer Electronic Engineering Textile & Garments Warehousing Building Material FMC	Land has been acquired. International bidding for hiring of developer is in progress the developers will be finalized at the mid of 2020. RFP floated in Oct, 2019, technical bid opening is planned on 11 th June and financial bid will be opened on 1 st July, 2020. Construction work has been started recently.
Bostan Industrial Zone	Baluchistan (1000 Acres)	Fruit Processing Agricultural Machinery Pharmaceutical Motor Bikes Assembly Chromite Cooking Oil Ceramic Industries Ice and Cold Storage Electric Appliances Halal Food Industry	Notified as CPEC SEZ on 4 th March, 2020 in 5 th Board of Approval meeting.
Allama Iqbal Industrial City, Faisalabad	Punjab (3217 Acres)	Textile Pharmaceuticals Information Technology Chemical Automotive Service Complex	Land has been acquired. Construction work started in Nov, 2019. Groundbreaking has been done on 3 rd Jan, 2020.
ICT Model Industrial Zone, Islamabad	Federal Capital City (200-500 Acres)	IT & related Industries Steel Food Processing Pharmaceutical & Chemicals Printing and Packaging Light Manufacturing	Land Finalization stage
Industrial Park Pakistan Steel Mills Port Qasim	Port Qasim near Karachi (1500 Acres)	Steel Auto & Allied Foundry and Fabrication Warehousing & Logistics Pharma Chemical Printing and Packaging Garments	Feasibility Study is at assessment stage.
MirPur Industrial Zone, AJK	Azad Jammu Kashmir (1078 Acres)	Mix Industry	Feasibility study is under progress.
Mohmand Marble City	FATA (350 Acres)	Marble & other Mix Industry	Feasibility study is in progress.
Moqpondass	Gilgit-Baltistan	Marble & Granite Iron ore Processing Fruit Processing & Value addition	Post feasibility stage. Government of GB is managing authority of the SEZ.

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SEZ	(250 Acres)	Steel Industry Mineral Processing and Value addition Leather Industry	
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Source:www.accaglobal.com(The Economic benefits of the modern silk road: the China-Pakistan Economic Corridor)

Conclusion:

Since the inception of CPEC, Pakistan has been witnessing an extraordinary rising path in the socio-economic domain, with a major lift in the sectors of energy and transportation infrastructure over the past years. However, internal and external security challenges are a potential threat which can reverse the developmental process through SEZs. State of Pakistan is working seriously on this point with the help of its forces, for this purpose Pakistan is fencing its border areas equipping the investigative institutions with latest technology to counter the hybrid war which has been waged against Pakistan by India to derail the CPEC project.

For the success of SEZs in Pakistan, it is necessary for the government that it decentralize its decision-making process and take all stakeholders on board while making policies regarding special economic zones. Further, information about the latest trends in market mechanisms and organizational structures must be valued during decision making. Decision-making must not be influenced by the interest groups. Local traders must seek the knowledge about the Chinese market demands and must prioritize their exports accordingly. They must export the best competitive products with quality assurance and must follow the deadlines of deliveries will give many benefits to exporters and traders of Pakistan.

In comparison to China, Pakistan is small country and despite of having a weak political and administrative structure regarding economy, it must decide its position and all parameters in a transparent manner. A carefully planned and strategic policy direction from the competent bureaucracy is needed for the maintenance of their sovereignty. The SEZs in Pakistan just started their journey and seeking guidance through the experiences of other states. So, it is recommended for the government to always be transparent in all kind of policies regarding SEZs with China. It is too early to get statistical results of growth rates in SEZs but it is clear that SEZs lead to a sure prosperity, if governments made firm decisions and remain unaffected by the interest's groups pressure tactics.

The Act of SEZs 2012 must be revised and make it flexible enough to attract the aspirations of the investors. Policy making must be carefully planned and must be decided with the co-ordination of expert firms of both countries. Fluctuations in economies may tend to designed and misplaced badly. A positive image of SEZs is mandatory and positive role of media in it will be

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beneficial to provide credible information. Rule of engagement must be in consultation with Chinese and Pakistani industrial leaders to ensure their success. For this good and efficient co-ordination between parties is necessary. The integration of private sector and local community within SEZs must be carefully monitored and must follow the market-oriented approach. An effective monitoring and evaluation cell must be established to resolve the commercial disputes.

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