

Report Part Title: Second Phase of CPEC

Report Title: A Road Map to Implement Second Phase of China-Pakistan Economic Corridor

Report Author(s): Shakeel Ahmed Ramay, Ayesha Ilyas and Ifra Baig

Sustainable Development Policy Institute (2020)

Stable URL: <http://www.jstor.com/stable/resrep24366.5>

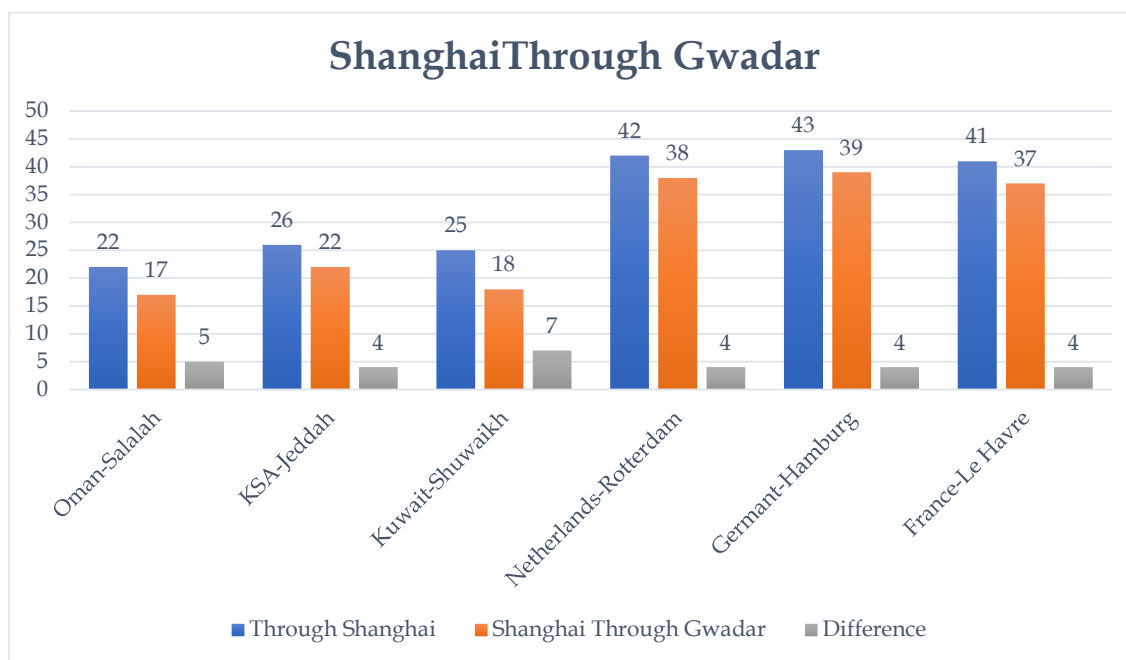
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Source: Authors' calculations

It is anticipated that after the completion of all infrastructure, the efficiency will be increased further. The change of mode of transportation (container to railways) will introduce substantial benefits. Therefore, it is important to study, design and implement second phase in such a way that it helps to consolidate and enhance the benefits of first phase.

3. Second Phase of CPEC

CPEC has now entered second phase. It brings a new set of opportunities and chance to enhance benefit from the first phase. However, before any intervention, the government must have to develop a matrix of past experiences, mistakes and learnings. The future strategy must be developed on the basis of past learnings. For example, one of the learning is that the decisions must be made on the basis of economic efficiency and not on political preferences. It will help to maximize benefits of CPEC in the long run.

Our analysis of past intervention suggest that government should focus on following four areas:

- Special Economic Zones
- Governance and Structural Reforms
- Backward Linkages
- Human Capital

3.1. Special Economic Zones

Industrialization is the main pillar of second phase. It will provide required sources of economic growth and help generate employment. Employment is considered main factor for trickle down of economic benefit. Therefore, success or failure of industrialization will determine the fate and perceived benefits of CPEC. It is envisioned that for the implementation of industrialization policy and plan, Special Economic Zones (SEZs) will play pivotal role. SEZs would provide basic infrastructure and impetus for industrialization.

SEZs across the world are being set up to cater for four or any one of four objectives of countries 1) Give impetus to industry, export and attract FDI, 2) generate massive employment opportunities, 3) introduction or supporting reforms and 4) experimentation of ideas, reforms, or strategies. Pakistan is looking to achieve four objects through SEZs under CPEC.

There is no second opinion about the potential of SEZs for rapid growth and industrialization. The belief in positive contribution of SEZs led to their exponential growth across the world. UNCTAD, 2019, showed that the number of SEZs increased from 79 in 1975 to 5400 in 2018 (World Investment Report 2019). However, the pre-requisite for the success of SEZs are sound planning, implementation and M&E. Planning and implementation include bundling all services at one-point to kick start the process of SEZs development, reforms and ease of doing business etc.

Good planning guarantees half success. Planning process should be rigorous, target oriented and consider domestic and global dimensions of SEZs. Therefore, Pakistan should adopt two prong strategy, 1) domestic, 2) global. For domestic level Pakistan should keep in mind that Pakistan is middle income country with huge population. Therefore, Pakistan needs to rationalize its objectives and try to focus on enhancing and strengthening industrial base, inclusion in global supply chains, technology dissemination, spillovers, and diversification of industry. On global dimensions, Pakistan analyzed its global commitments under World Trade Organization, Subsidies and Countervailing Measures (SCM), Trade-Related Investment Measures (TRIMs) and other regional etc.

Second, Pakistan would have to develop a rigorous, comprehensive and objective oriented monitoring and evaluation (M&E) plan and framework¹. M&E framework will help to keep the interventions at track and reduce wastage of resources. It will also help to refine and improve implementation strategies on basis of learnings.

Although, SEZs give an impression of success, enhanced production, increased export, GDP, etc., there are many SEZs which failed to deliver. Literature highlighted many reasons of failure. Some major reasons are as follows: (World Investment Report 2019, Zeng Z. D.;

1. Complicated institutional, legal and regulatory framework, which hinders the implementation of reforms and Zone's plans. Sometime, lack of institutional and legal reforms and absence of legal cover and execution institution severely impact the implementation of Zone. It has been observed that many countries try to establish SEZs without proper homework like in some African countries (Zeng, Z.D. 2012).
2. Inconsistent policy, it has also been observed in some democratic countries that with change of government, the policy also changes, and business community has to renegotiate with new government (Zeng, Z.D. 2012).
3. Excessive rules and regulations, difficult scenarios of compliance etc. Hurdles in establishment of business, like time for registration, connections of electricity, gas, water and other utilities
4. Introduction of industries or sectors which do not have foot print or capabilities in country
5. Enclave status of SEZs and weak linkages with local economy, linkages are critical to produce spillover effects
6. Low level of Human Capital
7. Bad law and order, it shakes the trust of investors

¹ SDPI is working to develop a comprehensive M&E framework for CPEC-2nd Phase

Exploitation of SEZs is another dimension. It has been observed that private sector most of time work only for profit, especially the multinationals and big corporations. They only invest if they see good return to their investment. It is especially true for big companies. They maximize their benefit and look for next destination. We can find many examples from across the world. For example, many USA's multinationals and big companies they have shifted their production facilities to other countries and USA is now worry about the creation of jobs. Moreover, they also try to avoid taxes and take their money to tax heavens. Government need to keep in mind this dimension and chalk out a way which can help Pakistan to avoid such exploitation in long run.

Last category of SEZs, which every country wants to have, includes the successful ventures. Many countries benefited from SEZs and China is one of such countries.

Case Study of China

Special Economic Zones (SEZs) in China account for providing employment opportunities to 30 million people with the rise of 22 per cent GDP (Zeng 2010). Study also estimated that SEZs have attracted 46 per cent of FDI with the increase of 60 per cent in potential exports of China.

(Alder et al. 2013) used panel data analysis to study the functioning of SEZs in major zones of 270 cities in China after the introduction of reforms at regional level. Study finds that major economic zones contributed 12 per cent to GDP and in future can contribute 20 per cent more. Wang (2013) studied 321 cities from time-period 1978-2008 in China. According to his study firstly, SEZs on average will add 21.7 per cent in per-capita FDI with 6.6 per cent increase in FDI growth rate. Secondly, these programmes will contribute to economy that will help in technological advancement of already installed programmes ultimately giving 8 per cent rise in wages of workers.

Yet, export diversification in China is still challenging. Schminke and Van Biesebroeck (2013) find that Economic and Technological Development Zones (ETDZs) experience higher export values in terms of numerous destinations and higher volume of trade as compared to Science and Technology Industrial Parks (STIP) that have expertise in exporting material to high-income countries by drawing higher export rates.

Literature review suggest following major interventions for turning an SEZ into a success story;

1. Better governance, law and order, better institutional framework, legal framework,
2. Strong linkages with local economies, inclusive supply chain, a proffered for trickle down strategy,
3. Livable vicinities, concept of affordable and healthy living, with quality services like health, education, etc.
4. Good incentive structure
5. Ease of doing business
6. Market size incentivize the potential industry
7. Provision of quality Human Capital
8. Export-oriented policies to incentivize investment an industrial sector. Investors and industrialists always look for destination, which support smooth export and provide incentives for export

Above discussion urges Pakistan to be cautious and adopt a wise strategy. The strategy must look for economic rational and try to avoid political interference, which can negatively impact SEZs. It must be based on the reality, facts and strengths of country and should avoid wish list strategy. For example, firms with good knowledge and experience in the field of production, marketing and distribution should be encouraged to take lead. It has been observed that these organization have positive spillover effect on other companies in country (Johansson, H. and L. Nilsson. 1997). We suggest a set of interventions for

the successful implementation of SEZs policy and achieve the desired results. We have developed a matrix of interventions (Fig-).



At present, Pakistan is facing problem in all sectors. The process to start a business is very difficult and complicated. For example, it takes 117 days to get electricity connection against 10 days in UAE. It takes 266 days to start construction. The story of other elements of ease of doing business is not different. Although last year Pakistan showed a positive progress in ease of doing business, but situation is still very complicated. Therefore, Pakistan will have to think deep and devise a good policy on the basis of good practices.

he starting point would be to ease the “Start of Business”. The government should adopt a “7-Days Policy”. It must establish a specialized office in each SEZs to facilitate the investors. These offices should be given autonomy and given protection by parliament. The mandate and sole purpose should be to fulfil start any business within seven days with ensured facilities and utilities, in the respective premises.

Second point would be to strike a balance between state-owned enterprises and private sector in each SEZs. It is very important. The logic behind this suggestion is that under BRI there are 126 partner countries. Every country will be competing to incentivize private sector. Private sector will decide on the basis of incentives and opportunities to maximize profit. It is a rational step for private sector but it can negatively impact any country. Private money can leave country and the country will not be able to stop it. Therefore, there is a need to strike a balance between State Owned Enterprises and private sector. Moreover, in private sector small and medium enterprises are given special focus. It is always difficult for small and medium enterprises to move from one country to another country.

Last point of entry would be that Pakistan should introduce some elements of innovation like eco-friendly industries of services. It will help Pakistan to promote the image of environment-friendly investment². Pakistan can also learn from the experience of Philippines in the field of eco-zones (FIAS. 2008).

3.2. Governance and Structural Reform

Governance has been highlighted as one area which determines the fate of SEZs. It can hinder smooth functioning of country and development of good business and employment opportunities and vice versa. Weak and bad governance leads to failure of SEZs. It is evident from the case studies of some African countries (Farole, Thomas. 2011).

Pakistan has been encircled between weak to bad governance. The spectrum of bad governance is evident from day to day business of state. It has impacted each sector of economy and society (our focus is economy). In economic terms, the worst affected sector is State-Owned Enterprises (SOEs), which were created to support country and add to revenue of state. Regrettably, most of the SOEs have been turned into bottomless holes and government is spending billions to sustain these enterprises. Now, the government is thinking to privatize these SOEs, which is again bad strategy in the long run.

Consumption-led growth of GDP is another element of weak institutional and governance outcome. Consumption in itself is not bad if it is being met by local production. Presently, consumption has met minimum support from domestic production sector.

Private sector governance, institutional support and legal framework is not business friendly. It is really in bad shape. All indicators, including ease of doing business, security, services, etc. are all in bad shape. The circumstances are discouraging business community to invest in the country. Even the completion of first phase of CPEC could not attract the perceived investment. Many businessmen from different countries visited Pakistan, but these visits could not yield desired results.

Therefore, the government should immediately start reforming its economic governance. Although the country requires comprehensive reforms, we will limit ourselves to the economic sector. The entry point for reforms should be SOEs. We suggest following reforms;

1. First of all, the government should introduce Corporate Social Model. It will ensure profitability and employment generation
2. The government should introduce competition for SOEs, the monopoly system should be abolished. For example, China introduced this concept in telecom industry and is reaping the benefits. Monopoly of SOEs like Steel Mills, PIA and others should be abolished.
3. De-politicize all SOEs

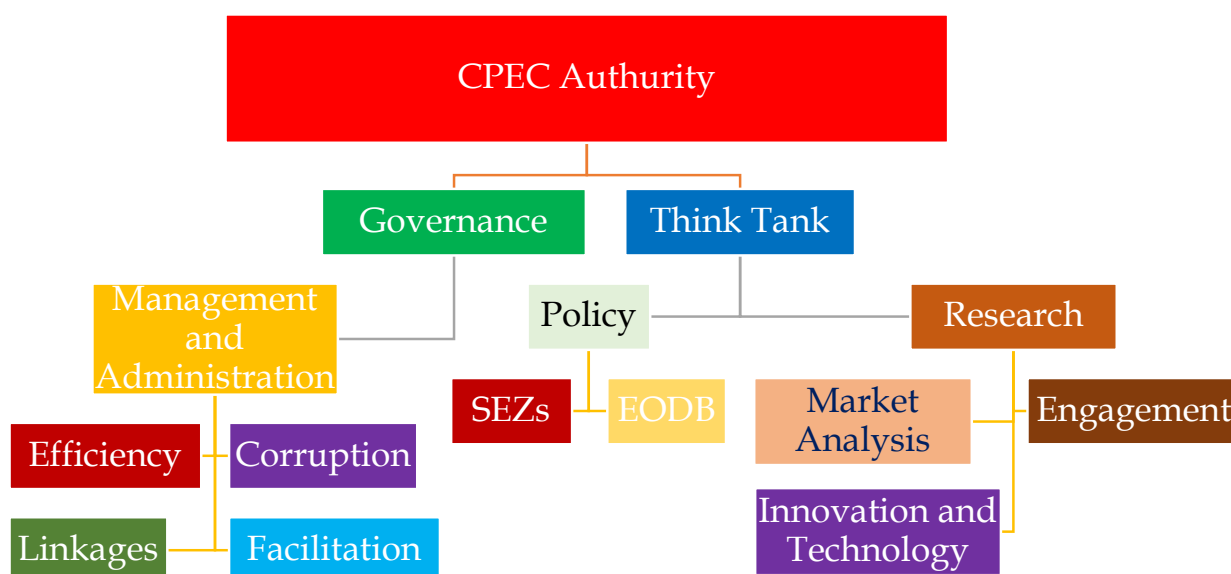
For private business government should look into following areas;

1. First and prominent field for interventions would be tariff modification and rationalization, and the ways to reduce border clearance days
2. The government will have to work on a comprehensive service sector strategy for business and transportation. Facilitation should have central stage in devising strategy. Digital support to services

² SDPI has developed ideas for eco-friendly industries

sector would be critical. It will enhance the efficiency of transport sector by on time availability of information. Digital connectivity, transport and e-commerce go hand in hand.

3. Allied services should also be provided and governance should be in line with good practices. For example, security of routes, food services, hotels and quality of roads and railways. These all will contribute to enhance the efficiency of transport sector and promote the use of network. In case of Pakistan, the country can benefit by presenting a good and reliable transit route for many countries. Pakistan can attract at least 4 per cent of China's global trade through CPEC route, if Pakistan applies good quality services. It will help Pakistan to collect the yearly revenue of US\$ 6 to 8 billion (Dr Nadeem Javed, May 2017, Reuter). These estimates were made on lower bond and it only presents a small proportion. Moreover, it will also help to increase Pakistan's export.
4. Another area of intervention would be time management and looking for the ways to enhance efficiency of interventions. We have witnessed some delays in some interventions, especially for business community. It is good to note that the government is cognizant of the fact and has erected CPEC-Authority that was a must step. However, now Authority will have to pave a smooth way for implementation and facilitation for business community. Authority should not confine itself to only management issues. It should also work to create a vision for the future of CPEC and related interventions. We propose following structure of the authority.



5. Lastly, the reform matrix of SEZs section must be implemented in true spirit. These reforms will help us improve not only the Ease of Doing of Business but also help to tackle issues of social and economic development. Inclusion of digital technology in governance will help to reduce human interaction as well as corruption. It will also enhance the efficiency of services. It would be vital intervention, as governance in Pakistan does follow the global definition or practices. In Pakistan, governance follows a model of "relation based" practices.

3.3. Backward Linkages

Major infrastructure cannot help to fully utilize the potential without sound backward linkages. Backward linkages will create conducive environment for business, trade and connectivity. For example, farm to market linkages, can only be done by creating linkages of major highways, and

motorways with small towns and villages. It will help small farmers and producers to deliver their products at lower costs and efficiently. In the case of agriculture products, it becomes even more important. As we know most of the products of agriculture sector are perishable commodities like vegetables, fruits and many others. Better connectivity will help farmers to reduce time of delivery and get good price. Moreover, it will also help Pakistan to enhance trade of farm commodities.

It is also critical to ensure trickle down impact of development. It has also been pointed out by the World Bank 2019, that due to weak backward linkages in Pakistan, internal trade may not flourish much. The bank also pointed out that the trade will only show a meager increase of 0.8 per cent till 2030. It becomes even more important, as second phase of CPEC specifically talk about agriculture development, social development and poverty alleviation. Quality backward linkages is one of the key areas for improving supply efficiency of farm products.

Therefore, the government will have to work on creating backward linkages of major transport and other infrastructure through policy. The government should immediately start working on it and ensure that till 2030 backward linkages should be at the final stage, if not completed.

4. Human Capital

The worst part of propaganda against CPEC is that China is importing labour. It is being portrayed that local population will be deprived of jobs. On the contrary, data shows that the first phase of CPEC produced 75,000 jobs for local people. Second, Pakistan severely lacks quality human capital. It is evident from the ranking of Pakistan as it is placed 134th on the Human Capital Index among 157 countries (World Bank, 2018). Every businessman and investor want good quality human capital. We need to understand that CPEC is an economic venture not a charity. Pakistan is already suffering due to low quality human capital and out of merit appointments. This is one of the major elements along with factors which contributed to poor state of SOEs in Pakistan.

Therefore, Pakistan needs a policy and strategy to produce quality human capital. Good thing is that the government has launched a programme to develop the human capital through Prime Minister's Youth Program. The government also has activated other institutions and departments to play their role.

China is also helping Pakistan to produce good quality human capital. For this purpose, a huge amount has been earmarked for skill development, education, and health in the second phase of CPEC.

Another area which needs attention of the government is how to motivate private sector to play its role in skills development. According to Apprenticeship Act, it is the responsibility of every industry to invest a certain portion of money on skill development. Skilled resources help to mitigate losses and enhance efficiency. It would be a win-win situation for everyone.

5. Conclusion

There are a number of areas which required attention, but we have restricted ourselves to only few. We studied three important aspects related to CPEC and BRI. First, we tried to find evidence, which can explain potential impact of impacts. Second, the paper discussed the propaganda against BRI and CPEC. The word "Propaganda" now seems synonymous to CPEC in Pakistan. It is a favorite subject to hit and try to present itself an independent analyst, researcher or commentator. Ms Alice Wells hardly miss any gathering or discussion without criticizing and propagating against CPEC. It cannot be said that she does not have required information because she knows what she wants to obtain by criticizing CPEC. Unfortunately, many Pakistani scholars and researchers follow the suit and start to criticize