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Innovative Financing for Special Economic Zones under CPEC

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INTRODUCTION:

Innovative financing is anything different from standard investing or financing practice that has the potential to deliver significant socio-economic or environmental impact"[3].This enlighten that innovative financing develops the activities for the wellbeing of the countries, through new approaches of pooling public and private revenues. The new income streams such as innovative taxes, issuance of bonds, fees, sales or any other scheme for voluntary contribution are reserved for the development purposes. In a few cases, the new financial mechanism has a dual agenda. Firstly, to raise new sources of financing by generating the development funds and secondly, to enhance the efficiency and effectiveness of the financial flows by making them more result oriented. There are different categories of innovative financing that are briefly discussed below:

CATEGORIES OF INNOVATIVE FINANCING

- **Taxes, obligatory charges or other dues on globalized activities:** create public revenues from private sector e.g. airline ticket tax, carbon tax etc.
- **Voluntary solidarity contributions:** In this form, customers can donate a small amount for a special cause e.g. product RED etc.

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[3] United Nations, "Innovative Financing for Development in Asia and the Pacific". Economic and Social Commission for Asia and the Pacific (ESCAP), 2017.

- **Frontloading and debt-based instruments:** Act as the public funds like issuance of bonds even in international markets e.g. diaspora bonds, green bonds, the International Finance Facility for Immunization and debt conversions.
- **Public-private incentives and state guarantees:** This includes the initiatives that leverage public funds to create investment incentives for the private sector. For instance, through state subsidies or commitments to purchase a product at a set price.

This study aims to discuss the importance of innovative modes of financing for the development of Special Economic Zones in Pakistan under China Pakistan Economic Corridor (CPEC).

SPECIAL ECONOMIC ZONES AND INNOVATIVE FINANCING

The main objective for the development of Special Economic Zones is to attract and strengthen the foreign direct investment. Therefore, to lure foreign investments in SEZs, incentives may be offered like tax holidays, lower corporate taxes than domestic firms, exemption from local income taxes, residential visas and the work permits for foreigners.

The Special Economic Zones play a dynamic role in the growth of an economy. SEZs promote technology transfer and improve the business environment[1]. Innovation in financial services is as vital as advancement in productivity because it offers new, better and cost-efficient products for the economic growth. Financial innovation is an act of creation and promotion of innovative financial instruments, technologies, institutions, and markets. Therefore, SEZs can stimulate the growth rates of a country by offering higher employment rate, expansion in the infrastructure, more currency exchange, technological development and so on[4] .

[4] Zeng, Douglas Zhihua. *Global experiences with special economic zones: focus on China and Africa*. The World Bank, 2015.

The efficiency of these zones is dependent upon the better business environment inside the zone, well-organized services like one-stop shop, good infrastructure, reforms for the improvement of business environment and a good balance between industrial and social/urban development.

Launch of the Special Economic Zones (SEZs) under CPEC has become essential for fast-tracked industrial development[2]. In this context, Pakistan aims at establishing resilient and potentially productive industries to initiate a new era of industrialization. While embarking on this phase of development, Pakistan will get many opportunities to capitalize on and hence, there would be a requirement to manage the challenges efficiently for the success of SEZs. Adopting the innovative financing options will help in the successful establishment of SEZs and to avoid the challenges.

International financial institutions (IFI) can perform an active role to make the innovative financing mechanism useful and overcome the challenges that Pakistan may face while establishing its industrial sector and Special Economic Zones[5]. The next section briefly discusses these roles for raising the funds efficiently and establishing effective SEZs.

ROLE OF INTERNATIONAL FINANCE INSTITUTIONS IN INNOVATIVE FINANCING

1. To help in attaining the autonomous ratings from the major credit rating agencies, IFIs can support countries.
2. IFIs can underwrite the expected high cost to be incurred by the first issue of debt instruments.
3. To produce legal templates for facilitation of debt issuance, IFIs can arrange seed money.

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[5] Mahmood, Zafar. "Opportunities and Challenges of Special Economic Zones under CPEC for Pakistan." *The International Academic Seminar on Industrial Cooperation and Construction of Industrial Zones, CPEC", Beijing China, 5-7 January 2018.*

4. IFIs can provide awareness to the public and private sector about the potential of innovative options of financing and its techniques.
5. To eradicate the problems of liquidity, IFIs can issue GDP indexed bonds with coordination of several countries.
6. IFI's can assist in provision of reliable data for innovative financing deals.

Innovative Financing for Special Economic Zones in Pakistan

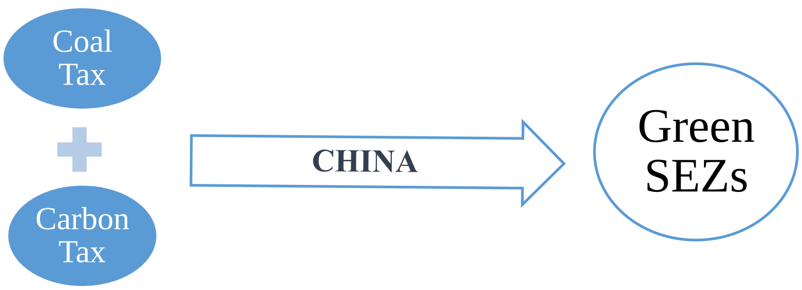
The key to the economic revival of Pakistan is a well-developed industrial sector. This can be achieved if there is rapid industrialization and a boost in production and exports through Special Economic Zones.

Pakistan needs to improve its ranking on various indices in the international market by offering conducive environment for the new businesses and with high standard manufactured exports. To overcome all the existing economic issues, developed industrial sector can play a vital role. SEZs are the best option to quickly achieve a higher path of industrialization. According to SEZs act of Pakistan, the government would either set up SEZs on its own or in cooperation with private entities under numerous modes of collaboration. The next section discusses the possible innovative financing options that have been exercised in other countries for the successful formation of their Special Economic Zones.

a. **Diaspora Financing:** Diaspora investment can be one of the major sources of funding for the development of Special Economic Zones. Developing countries are continuously formulating strategies to attract their diaspora through economic zones. Pakistani diaspora can also be attracted towards the development of SEZs through their management skills, technology and capital investment to establish the capacity at local level. Taiwan, Ireland, Turkey, China India, and Israel have engaged their diaspora for the financing of the Special Economic Zones and captured the benefits[6].

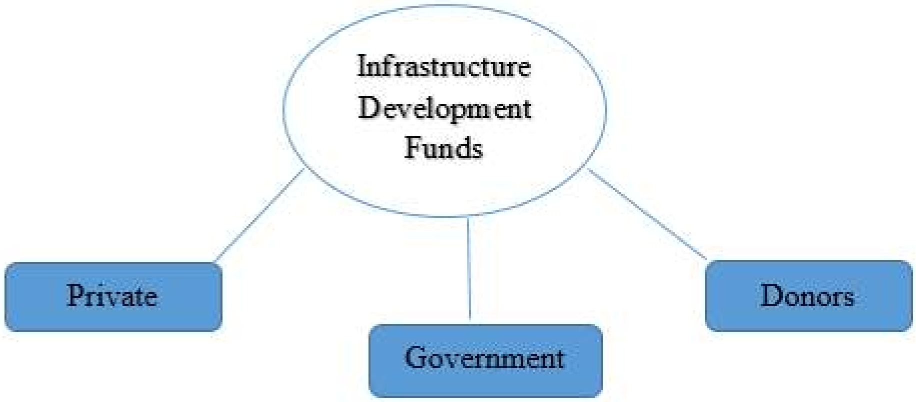
b. **Public Private Partnership:** Public private partnership is also an effective tool to finance the Special Economic Zones. In this form of financing, support and coordination from different private and public entities are required for mutual benefits. India and China have generated funds through this mode for the development of their Special Economic Zones. There are various success stories attached with this mode of financing for SEZ in different countries including Nepal, Lebanon, Senegal, Liberia, Jamaica, India, China, and Russia.

c. **Carbon Taxes:** The carbon finance mechanism has the potential to channel the new funds and develop green SEZs[7]. Carbon taxes offer an incentive to governments, businesses and people to efficiently reduce the carbon emissions. China has introduced the coal tax to finance its Special Economic Zones[8]. This mode has been adopted by UK, Canada, India, China, EU, and USA.



[6] Makolli, Zekiri. "Diaspora Invetment on Economic Zones". United Nations Development Programme, Kosovo, 2013.
[7] António, Nelson &, ShaZhuang & Ma, Shaozhuang. China's Special Economic Zone in Africa: context, motivation, and progress. Euro-Asia Journal of Management. 79-103, (2015).

d. **Special Economic Zone Fund: Special** Economic Zone Fund involves the operators of Industrial Development Zones and local/foreign third-party investors. A SEZ fund intends to provide multiyear funding for the infrastructure of Special Economic Zones and to enhance the growth of manufacturing sector through improvement initiatives. The SEZ fund is run by professional management and its main responsibility is to find new companies, entrepreneurs, or new subsidiaries of existing companies to invest. South Africa has used special economic zone fund for development of their Special Economic Zones.
e. **Consortium of Firms:** Consortium of firms is association of different institutions including international banks, development banks and firms. Member banks of consortium invest for the sustainable development in client countries in the form of loans and grants. The funds related to environment may support development of eco-industrial parks. The consortium of companies has financed the Special Economic Zones like Lekki Free Trade Zone of Nigeria established by Chinese consortium and Nigerian interest.
f. **Infrastructure Development Funds:** The Infrastructure Development Funds can be one more option to raise funds for the development of SEZs. A special fund created through contributions of Government, donors, and private sources for infrastructure development. Such funds are managed by an intermediary such as a development bank, which grants funds to the Government to develop or on-lend to developers at a margin. This mechanism is used by Indonesia and Nigeria.



g. **An Investment Fund:** This type of investment mode is usually adopted for the development of Eco Industrial Parks (EIP). The funds can be channeled through small investors in the form of investment fund and it can be designed on the model of an enterprise fund to facilitate companies in EIP or serving its tenants. Establishment of these funds not only enable the resident of the country but also attract the overseas social venture participants. The fund's management has to serve as the interface between the management of the project and the individual investors for the decision making. United Kingdom, Greece, Ukraine, France and Switzerland have used this structure to finance SEZs in their countries.

h. **An Action Foundation:** The framework presented by Indigo Development depicts strategies for Eco-Industrial Park development which incorporates the concept of An Action Foundation with the objectives of enhancing the sustainability of local environment, society, economy, and improvement in the self-reliance. In this form, the funds are generated from public, developers, and EIP tenants. Usually, this type of foundation provides funds for the projects and programs related to the sustainable development, policy development, graduate fellowship, and research on specific technology. South

America, Australia, South Africa, Namibia, Asia, and Europe used action foundation for development and management of industrial parks.

Sr. No.	Modes of Financing	Countries/Regions
a)	Diaspora Investment	China, India, and Israel
b)	Public Private Partnership	Nepal, Lebanon, Senegal, Liberia, Jamaica, India, and China.
c)	Carbon Taxes	UK, Canada, India, China, and European Union.
d)	Special Economic Zone Funds	South Africa
e)	Consortium of Firms	Nigeria
f)	Infrastructure Development Funds	Indonesia and Nigeria
g)	Investment Funds	UK, Greece, Ukraine, France, Switzerland
h)	An Action foundation	South America, Australia, South Africa, Namibia, Asia, and Europe

TABLE: 1 MODES OF FINANCING FOR SEZS IN THE WORLD
Source: Author's contribution

CONLCUSION:

The importance of developed Special Economic Zones cannot be overlooked if a country is aiming at increased Foreign Direct Investments, rapid industrialization and more employment opportunities. Developed Special Economic Zones offer more economic benefits, such as increased local production, higher exports, foreign exchange, revenues and decrease in the balance of payment deficits. Pakistan needs to improve its business environment and attract foreign investment in the Special Economic Zones by adopting various modes of innovative financing. To improve growth rates through fast industrialization and development of Special Economic Zones, Pakistan would have to overcome the challenges like:

- Adopting efficient modes of innovative financing for the development of Special Economic Zones.
- Providing a conducive business environment for new and existing businesses with strategies that focus on ease of doing business in the country and attract more FDI.
- Offer reduced costs and establish best trade facilitation system.
- Awareness of the new International Financial Architecture and its impact on Pakistan and specifically on Special Economic Zones.