Special economic zones: Can SA follow in the Dragon's footsteps?

By Charmaine Pretorius

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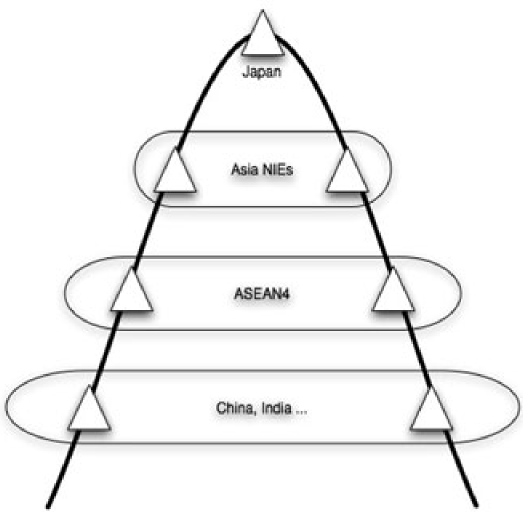
Special economic zones (SEZs) have become the new buzzword for African governments, who see in them the long-awaited salvation from the poverty scourge that has gripped the continent despite decades of structural reform programmes.[2] SEZs are generally defined as specially demarcated areas that offer unique incentives for a diverse range of economic activities.[3]

On the other hand, free trade zones (FTZs), usually found next to sea ports and airports, allow unrestricted import and export of goods free of customs, while export processing zones (EPZs) specifically encourage investment and manufacturing for export.[4] China's success with its SEZ model has caught on with African leaders eager to try something new.[5]

African countries stand to benefit not only from Chinese know-how, but also much needed foreign direct investment (FDI) as large Chinese companies are the first to set up shop within many of Africa's SEZs.[6] But success for China does not necessarily mean success for Africa. While SEZs brought unparalleled growth to China, it remains to be seen if this Chinese model of development could be transplanted successfully onto African soil, and what steps are necessary to do so.[7] This paper analyses the prognosis for SEZs in Africa, first by looking at SEZs as the drivers of development, then at opportunities for both China and Africa, and finally at some of the challenges facing the continent, in particular South Africa.

Drivers of economic growth and modernisation

In the 1980s, the main catalyst for development in East Asia was the Flying Geese Model, the multi-tiered development of Asia that was led by Japan, the first industrialised nation in the region.[8] The model identified four stages: the import of consumer goods from industrialised countries; local production of previously imported goods while imports shift to capital goods; exporting the newly manufactured goods; and finally, local production on the same level as the industrialised country, with consumer goods exports declining and capital goods exports increasing.



Flying Geese Model of economic development in Asia [9]

In 1985 Japan began looking for alternative markets following the signing of the Plaza Accord, aimed at correcting trade imbalances between the United States (US) and Japan.(10) It effectively closed the US market to Japanese exports. Japan turned first to Hong Kong, Singapore, South Korea and Taiwan and thus started the industrialisation of the four Asian Tigers - the second tier of Asia's development. The third tier extended to the Association for South East Asian Nations (ASEAN), which at the time included only Indonesia, Malaysia, the Philippines and Thailand; and then to China and India. In the same way, China is now leading the Flying Geese migration to other developing countries.(11)

In 1978, Deng Xiaoping, then chairman of the Chinese Communist Party's Central Military Commission, realised that the path to economic development was to open up the country to foreign investment, by throwing open the gates to the isolated Middle Kingdom in what has become known as Deng's 'Open Door Policy'.(12) SEZs had been successful elements in the industrialisation of the Asian Tigers, and in 1979 China established its first four SEZs. The zones were strategically placed to attract FDI from wealthy and newly industrialised economies (NIEs), where labour costs were beginning to reach unprofitable levels.(13)

In her book, The Dragon's Gift: The Real Story of China in Africa, Deborah Brautigam, a professor at Johns Hopkins University's School of Advanced International Studies, contends that China's SEZ success in particular could be ascribed to a mix of proactive leadership and policies. This included efficient bureaucracy; independence for local authorities to make decisions; close cooperation between investors and government planners; duties on imported equipment; housing benefits for investors; the right to hire and fire workers; and good infrastructure. In the 1990s as part of its soft power strategy, China started exporting its SEZ model to the rest of the world, on condition the zones were built and managed by Chinese investors.(14)

How the Dragon will feed the Lions

Labour costs in China are rising; within the next few years the country might start losing its competitive advantage as part of the natural production cycle.(15) A 2011 study by Dublin-based management consulting company Accenture showed increases in Chinese wages of between 8% and 32%, with increases expected to continue.(16) In 13 of China's provinces wage increases topped 20%. However, some scholars are doubtful whether Africa is a suitable alternative destination for investor capital. World Bank Senior Economist Guiseppi Iarossi contends, for example, that Africa is not cheap, and instead argues that the continent is "one of the most expensive places in the world to produce."(17)

Nevertheless, for Chinese companies investing in SEZs or FTZs in Africa, the motivation is not purely low-cost labour. China's overseas zones allow mature industries in the Chinese SEZs to transfer abroad, especially where there is excess production such as in textiles and other light industries. The SEZ in Ethiopia, for example, focuses on textiles, leather and construction, while the Chamibisi SEZ in Zambia specialises in metal processing and electronics assembly.(18)

Brautigam has noted that Chinese investors stand to benefit indirectly from Chinese government grants, long-term loans and tax incentives, easier access to China's foreign exchange reserves, as well as other markets limited to Chinese producers within China.(19) Setting up businesses in Africa would aid "high value-added Chinese brand name companies with their own intellectual property" to become multinational firms.[20] Of particular importance is the US$ 1 billion China-Africa Development Fund, established in 2006 to provide venture capital to Chinese firms.[21]

But how will this benefit Africa? It is imperative to remember that structural adjustment programmes under the auspices of the International Monetary Fund (IMF) and the World Bank - the so-called Washington Consensus - have all but decimated the continent since the 1980s, leading to increased poverty and decreased income.[22] Prior to the era of structural adjustment in the 1980s, the gross domestic product (GDP) of Sub-Saharan Africa (SSA) grew almost 40%, but between 1980 and 2000 it decreased 15%.[23] Discontent with the programmes created near-perfect nesting grounds for the Flying Geese of East Asia's development to head for the Global South. The success of Asia's zones was compelling and since the 1990s many African countries have independently established similar zones.[24] Comparative data on the achievements of zones, however, are not readily available, but according to Thomas Farole, senior economist at the World Bank, marked successes have been achieved by some of the 114 zones in Africa. These include Ghana, Kenya, Mauritius and Madagascar. Zones that have had limited success include those in Malawi, Mali, Namibia, Nigeria and Senegal, due to poor governance and management, lack of sufficient policy and improper location of zones, among other reasons.[25]

Some of China's biggest and most successful zone operators were invited by SSA countries in 2006 and 2007 to bid in a rigorous two-round tender process for the right to establish and manage SEZs. Set up specifically with funding from the Chinese Government, these zones include: in Ethiopia, Oriental makes electric machinery, steel and metallurgy and construction materials; in Mauritius, Jinfei focuses on manufacturing, trade, tourism and finance; in Nigeria, Lekki specialises in transport equipment, textile and light industries, and telecommunications, while Ogun specialises in construction materials and ceramics, ironware and furniture, medicine, computers and lighting; in Zambia, Chambisi focuses on the copper industry while the Lusaka sub-zone focuses on garments, food, tobacco, appliances and electronics. Several provinces and private companies in China have been experimenting with smaller FTZs and industrial parks in Botswana, Guinea, Madagascar, Nigeria, Sierra Leone and South Africa.[26]

South Africa was not one of the countries that bid for SEZ management by Chinese conglomerates. Despite requests for information on the reasons for this, the South African Department of Trade and Industry (DTI) did not respond. The country will probably not benefit from the start-up FDI and know-how offered by the Chinese in setting up its SEZs.

Challenges and opportunities for South Africa

South Africa's first experimentation with development zones in the 1990s was not as successful as the country had hoped. In a 10-year assessment of the Industrial Development Zone (IDZ) programme in South Africa, the Centre for Development and Enterprise (CDE) said there were little or no tax incentives, inconsistent investment incentives, strict admission criteria, and non-discounted property prices.[27]

The IDZs in South Africa were established as part of a government drive to put South Africa on the road to an export-led growth economy. Coega, near Port Elizabeth in the Eastern Cape, was the first IDZ to open for business in 2001. Ten years after its establishment, Coega, managed by the Coega Development Corporation, has attracted around 20 investors, most of them relocating from other industrial zones.[28] The East London IDZ (ELIDZ), managed by the Eastern Cape Development Corporation, started up a year later. Most of the 30 investors in this zone do work for Mercedes Benz, but due to the capital-intensive nature of investments in the zone, employment creation was limited. In 2013, Johnson Controls Automotive announced a ZAR 380 million (US$ 37.5 mllion) investment to expand operations in the zone. To date, the zone has 14 automotive investors with a shared investment of ZAR 1.2 billion (US$ 118.5 million).[29]) The third IDZ was established in Richards Bay in 2002, operated by the Richards Bay Industrial Development Corporation. Its focus is on minerals beneficiation, heavy metals, building products, dry docks, renewable energy, rubber recycling, agro-processing and granite processing. Since the severe 2008 electricity shortages in South Africa, very few investors have shown interest in the zone. The latest IDZ to be created is the OR Tambo IDZ in Gauteng Province. While its focus is on supporting industries linked to air transport, there is still a lack of investment.

Data on job creation in the zones differs, but according to the DTI more than 33,000 jobs were created - 27,000 at Coega, over 5,000 at East London, and just over 300 at Richards Bay.[30] There does, however, appear to be consensus that South Africa's four IDZs have failed to deliver on their initial aims. Reasons vary, but according to the CDE, lack of coherent policies and political commitment could be blamed. Despite international case studies, the South African Government has failed to adhere to best practices for its zones. Trade and Industry Minister Rob Davies has acknowledged as much, and stated some of the major challenges facing South Africa's SEZs are insufficient coordination and planning, dependence on government funding, lack of coordination among government agencies, and failure to adequately promote investment opportunities. ELIDZ chief executive Simphiwe Kondlo summed up the situation:

Operators of IDZs have found the experience very challenging, partly because many people see IDZs as having been established by government without involving the key players whose support the programme needs. A prime example of this is the failure to establish customs-controlled areas....but the DTI had to rewrite its IDZ regulations around 2004 because customs policies fall outside its remit, and SARS was not properly involved. Thus, the foundation for IDZs was not firm enough to provide for a comprehensive programme in South Africa.[31]

Political will versus political want

In 2012, the IDZs were renamed by the DTI to become South Africa's first SEZs.[32] It would seem the government has taken heed of some of the issues that have hampered development of the SEZs. The new SEZ legislation provides a clear framework for development, operation and management. Implementation will be a coordinated effort. The new strategy allows for comprehensive support in terms of infrastructure, skills development, technology, research and development, market support and access, and financing.[33] Investment promotion will be coordinated between the zones and the DTI, and zone governance will be specified. For example, the provincial member of the executive council or an appointed executive mayor will assume accountability for the zone operations.[34]

Apart from effective legislation, political commitment is vital to the success of SEZs, and Farole makes a distinction in this regard between "political support" and "political objective."[35] He argues that for any SEZ to be successful it requires political commitment or support, but its implementation must be based on clear commercial principles without political objectives. For South Africa, political objective may hold sway over political support as job creation becomes a political platform ahead of the country's national elections due in 2014.[36] When the northernmost province of Limpopo was the first to be granted licences for two new SEZs earlier in 2013, the former provincial Premier, Cassel Mathale, hailed the decision as a success for employment creation.[37] South African President, Jacob Zuma, promised 500,000 new jobs in 2009.[38] Two years later, he declared 2011 to be South Africa's "year of job creation" and promised 5 million new jobs by 2020 as part of the government's New Growth Path (NGP).[39]

In deciding to open SEZ licences to bidding, the South African Government might have inadvertently also risked inter-provincial competition in a "race-to-the-bottom" - a situation where companies and countries, or provinces in this case, compete by cutting wages and living standards for workers.[40] The FDI cake is only so big and in addition to sharing the slices between provinces and the already existing SEZs, South Africa will have to share available FDI resources with other African countries. Each of these players will be acting in self interest as they try to outbid each other in offering incentives to foreign investors.[41]

It would make sense then to heed critics who warn that instead of fostering development, SEZs could be a tool for governments to avoid dealing with domestic inefficiencies.[42] Both political and economic reform is required to ensure the success of an SEZ, Mauritius being a case in point. The Jinfei SEZ in Mauritius was set up as a pillar for development with the help of strong political commitment and efficient bureaucracy.[43]

Literature on the reasons for SEZ failure is plentiful and some have already been mentioned. Other causes that stand out include the reliance on employment creation as the basis for setting up zones; over-dependency on low-cost labour; unsustainable incentives; failure to integrate the SEZ economy with the national economy; lack of political commitment; and poor infrastructure and unreliable electricity supply, which are viewed as more critical than even financial incentives.[44]

Infrastructure and power constraints could possibly pose challenges for South Africa in setting up its SEZs. The World Bank's 2013 Doing Business rankings placed South Africa at 150 out of 185 countries in terms of securing electricity.(45)

Concluding remarks

SEZ success in Africa has been limited at best, but it might be too early to deliver a verdict. Many SEZs in Africa started operating only in the new millennium. They face daunting challenges and, just as the Asian countries needed assistance, so too does Africa. Best international practice for SEZs is available, and African leaders need to heed it and be proactive. On the other hand, those African zones that have failed or are faltering could probably blame their problems on lack of political commitment and unsustainable policies.

South Africa's first attempts at establishing zones did not bring the success expected, but the country appears to be willing to learn from its mistakes. The government has acknowledged the challenges of economic stimulation and job creation, which will include better coordination and governance, and a more efficient policy framework within which investors can operate.

Whether Africa can successfully copy the Chinese SEZ model depends more on what Africa does with it than on the model itself. The model's success has been proven; Africa's attempt at effecting economic change through SEZs has not.

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ABOUT THE AUTHOR

Charmaine Pretorius is a South African freelance journalist. Contact Charmaine through Consultancy Africa Intelligence's Industry & Business unit at [[industry.business@consultancyafrica.com]].