

**A CASE STUDY FOR SPECIAL ECONOMIC ZONES  
IN SOUTH AFRICA AS A MEANS OF ATTRACTING  
FOREIGN DIRECT INVESTMENT**

by

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Thesis

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## **Declaration**

**I declare that this Mini-Dissertation which is hereby submitted for the award of Legum Magister (LL.M.) in Trade and Investment at International Development Law Unit, Faculty of Law, University of Pretoria, is my original work and it has not been previously submitted for the award of a degree at this or any other tertiary institution.**

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**31 May 2012**

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## Abbreviations

BIT	Bilateral investment treaties
CCA	Customs Controlled Areas
DFI	Development Finance Institution
DTI	Department of Trade and Industry
FDI	Foreign direct investment
IDZ	Industrial development zone
MTEF	Medium-Term Expenditure Framework
SEZ	Special economic zone
UNCTAD	United Nations Conference on Trade and Development
WCO	World Customs Organization
WEPZA	World Economic Processing Zones Association
WTO	World Trade Organization

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“Indeed, the zone concept is so powerful, that more and more countries are recognizing a new paradigm of free zones. While the old free zone was often described as a static, labour-intensive, incentive driven, exploitive enclave, the new zone paradigm is a dynamic, investment-intensive, management-driven, enabling, and integrated economic development tool.”

RC Haywood

## Chapter 1

### Introduction

#### 1.1 Research Subject

Recently, an article was published in *The Star Business Report*,<sup>1</sup> commenting on the current state of African trade. According to Valentine Rugwabiza, deputy director-general of the World Trade Organization (WTO), Africa is experiencing exceptionally low levels of intra-Africa trade. This low level is restricting the potential development of the African continent. Currently, Africa's entire share of world trade is less than 3%. This situation is attributed to Africa's narrow range of exports and over-dependence on primary products. To address this problem, the article comes to the conclusion that there has been insufficient investment in infrastructure throughout the African continent. This can best be emphasised by the following statement by the President of Ghana:

Ghana was the first sub-Saharan nation to win its independence from a colonial power in 1957, yet the average per capita income of my people is lower than it was in the 1960's, four decades after independence. Some of the blame for this we Ghanaians must accept. My country must acknowledge that corruption is a cancer on our public and economic life and must be contained. One hundred years ago, our trading was limited to the supply of raw materials, mainly gold, timber and cocoa. One hundred years later, our trading consists of raw materials, mainly gold, timber and cocoa. I must admit that Ghana's path to self reliance has not been smooth. I am painfully aware that it has been characterised by one step forward and two steps backward.<sup>2</sup>

Sadly, the story of Ghana is not unique to the African continent. Industries in Africa are poorly developed and exports remain mainly in

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<sup>1</sup> Wednesday, 18 April 2012

<sup>2</sup> SN Ngwenya *Advocates for Change: Regional Integration in Africa* (2011) 261.

primary commodities. However, governments within Africa are slowly starting to implement industrial policies with the sole purpose of diversifying and expanding its export markets. One such policy instrument used is the implementation of special economic zones (SEZs). South Africa is no exception in this implementation. After South Africa became a party to the Marrakesh Agreement of the WTO in 1995, a period of excessive liberalisation followed. This entailed the reduction and restructuring of the tariff structure, the abolition of surcharges and the scrapping of the General Export Incentive Scheme.<sup>3</sup> This created advantages for South Africa such as lower market concentration, enhanced contestability, increased product differentiation as well as enhancing the rate of innovation.<sup>4</sup>

These advantages enabled South Africa to use SEZs as a tool to kick-start industrialisation. This created new economic opportunities as well as employment opportunities, which by extension generate income for consumption. In Africa, it is true that many countries are poor and have scarce resources for investment in productive capacity and, consequently, they try to attract foreign capital to produce goods and services for foreign markets.<sup>5</sup> There are also those that, by contrast, have good access to capital but potential investors have limited incentives to invest owing to regulatory restrictions, trade barriers and inefficient administration.<sup>6</sup> Both of these situations create trouble for investors. Thus in order to attract foreign investment government intervention is relaxed and incentive packages are attached for capital investment in export-oriented production in a limited area. This is probably the main strategy used by governments to attract investors to SEZs in the hope of stimulating economic activity.

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<sup>3</sup> AA Dippenaar: “Industrial Development Zones as a Policy Instrument in South Africa” (2001) p 18.

<sup>4</sup> Ibid.

<sup>5</sup> M Engman, O Onodera and E Pinali “Export Processing Zones: Past and Future Role in Trade and Development”; OECD trade Policy Working Papers, No. 53, OECD Publishing, Part 2 (2007) 51.

<sup>6</sup> Engman et al (2007) 51.

For developing countries, SEZs have traditionally had both a policy and an infrastructure rationale. In terms of policy, the SEZ can be a useful tool as part of an overall economic growth strategy to enhance industry competitiveness and attract foreign direct investment (FDI). Through SEZs, governments aim to develop and diversify exports<sup>7</sup> while maintaining protective barriers, to create jobs, and to pilot new policies and approaches (e.g. in customs, legal, labour and public-private partnership aspects).<sup>8</sup> SEZs also allow for more efficient government supervision of enterprises, provision of off-site infrastructure and environmental controls.<sup>9</sup>

The fate of SEZ initiatives has to a great extent been determined from the outset by the choices made in the establishment of policy frameworks, incentive packages and various other provisions and bureaucratic procedures. Experience suggests that maximising the benefits of zones depends on the degree to which they are integrated with their host economies and the overall trade and investment reform agenda. In particular, when zones are designed to pilot legal and regulatory reforms within a planned policy framework, they are more likely to reach their objectives.<sup>10</sup>

Some countries have established SEZs to increase foreign exchange earnings while yet others have aimed to stimulate production of non-traditional exports such as electronics and automobiles. SEZs have also been located in disadvantaged regions or cities to tackle unemployment. With time, some countries have benefited from the significant dynamic effects that foreign investment can bring.

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<sup>7</sup> According to the *World Trade Report* (2011) 31, South Africa's total merchandise exports peaked at \$82 billion, which is up 10% from 2005. South Africa's exports of commercial services for the same year peaked at \$14 billion, which is up only 5% since 2005.

<sup>8</sup> FIAS "Special Economic Zones Performance, Lessons Learned and Implications for Zone Development" (April 2008) 34.

<sup>9</sup> *Ibid.* 1.

<sup>10</sup> *Ibid.*

The development of SEZs has not come without significant costs. One of the reasons for investor success in some SEZs is that they avoid many of the costs of taxation, labour standards, human rights oversight, and safety and environmental regulations to which other sectors in the same country must adhere when doing business.<sup>11</sup> It can be argued that these regulatory avoidance mechanisms ultimately benefit the citizens because SEZs bring employment and infrastructure to the area, while, on the other hand, it can also be argued that the zones' benefits are not worth the degradation that the SEZs cause to a developing country.

Industrial development in South Africa is a top priority as it holds the key to economic prosperity and success. The country needs to create and sustain economic opportunities in all its regions, especially the underdeveloped regions, develop much needed regional development platforms, create jobs for a growing population, and improve the general living standards of its citizens. Accordingly, SEZs can be useful instruments to support national and regional industrial development policy objectives, but they require strong coordination at all levels of government, adequate financial and technical resources and clearly targeted industrial capabilities and investments.

There is a comprehensive menu of SEZs that can be used in the various regional contexts.<sup>12</sup> Richard Bolin, co-director of the World Economic Processing Zones Association (WEPZA), presented convincing evidence as to the success of zone implementation. The levels of exports from 1993 to 1996 in countries exporting to the United States and Europe were as follows: Those with zones in the lower middle income had an increase in exports of 72%, and those without zones, 1%. In the upper middle income countries, those with zones 62%, and those without

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<sup>11</sup> M Murray "A Survey of Special Economic Zones" (February 2010) <http://blogs.law.uiowa.edu/ebook/faqs/what-are-special-economic-zones> (accessed October 2011) p 7.

<sup>12</sup> "Policy on the Development of Special Economic Zones in South Africa" (2012) 22.

zones only 33%.<sup>13</sup> Clearly, there must be an advantage to having these zones.

## **1.2 Problem Statement**

In 2000, the South African government established the Industrial Development Programme. The main focus of this programme was to attract foreign direct investment and generate exports of value-added commodities. However, there were many limitations and shortcomings associated with this programme which, in turn, provided government with the rationale for a more inclusive industrial facilitation model in the form of the proposed SEZ programme.<sup>14</sup> Although the achievements of the existing IDZs have been acknowledged, government nevertheless felt that more could be achieved if the challenges identified within the existing IDZs could be effectively addressed. The SEZ programme is intended to address these challenges and build upon the previous development programme.

## **1.3 Research Question**

Throughout this study, the central theme will encompass the question of whether the new draft Special Economic Zones Bill and policy will be able to attract the much desired FDI, as well as achieve or contribute to South Africa's overall development strategy. Instead of developing and addressing the shortcomings of the previous IDZ programme, which was introduced through the Manufacturing Development Act,<sup>15</sup> an entirely new Act and policy is proposed. This begs the question of which is better, the devil you know, or the devil you don't?

## **1.4 Thesis Statement**

As a developmental tool, SEZs are absolutely essential to a country and South Africa cannot afford to lag behind. As South Africa is regarded

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<sup>13</sup> RC Haywood: "Economic Realities and Free Trade Zones" (2004).

<sup>14</sup> "Policy on the Development of Special Economic Zones in South Africa" (2012) v.

<sup>15</sup> Act No 187 of 1993.



as the window into Africa and with more investors wishing to establish a base of operations within South Africa, SEZs provide an excellent environment for these investors. However, a clear and transparent legal and policy framework is essential to attract potential FDI and create certainty and security among investors.

### **1.5 Structure of Thesis**

The thesis is structured as follows: Chapter 2 will primarily focus on the concept of SEZs; what they are and where they are encountered. An attempt is made to determine the importance of the SEZs to developing countries. This is partly so as to justify the study and to outline its relevance. Chapter 3 specifically focuses on SEZs in South Africa. The chapter traces the history of SEZs in that country and their evolution through to their current status, and also analyses the strengths and weaknesses of the concept. Chapter 4 emphasises the importance of FDI for a country such as South Africa, and the way in which SEZs can be used to attract potential investors. Chapter 5 takes into account miscellaneous issues with regard to SEZs and considers their potential advantages and disadvantages. Chapter 5 concludes the dissertation.

## Chapter 2

### Introduction to Special Economic Zones

#### 2.1 What is a Special Economic Zone?

Special economic zones<sup>16</sup> (SEZs) are a policy instrument that has been used by governments all over the world to promote trade and FDI in the host countries. These policy instruments, referred to as SEZs, have become increasingly common as countries have shifted from import substitution policies to export-led growth policies.<sup>17</sup> According to statistics provided by the International Labour Organization (ILO), the number of SEZs has increased exponentially from 79 in 25 countries in 1975 to some 3 500 zones in 130 countries in 2006, employing an estimated 66 million workers, 26 million of whom were employed outside China.<sup>18</sup> SEZ programmes are considered to be a very effective tool used by many economies to promote trade, economic growth and industrialisation.<sup>19</sup> The zones act as a magnet for investment in desirable activities in specially designated areas by providing quality infrastructure complemented by an attractive incentive package, business support services, cluster development and minimal red tape.<sup>20</sup>

There are many definitions for an SEZ. However, the most broadly used definition defines a special economic zone as “being part of the territory of a contracting party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the customs area”.<sup>21</sup> The main aim of these SEZs is to attract FDI to the host country. SEZs can take on any form that is

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<sup>16</sup> Most texts use a variation of the following names: free zones, foreign trade zones, export processing zones, free trade zones, special economic zones and industrial development zones. To avoid confusion, this research paper uses the generic term “special economic zones” or “SEZs” to encompass the range of modern free-zone types worldwide.

<sup>17</sup> Engman et al. (2007) 8.

<sup>18</sup> “Agenda for the International Labour Conference” ILO Governing Body, 312 Session, Geneva (November 2011) 17.

<sup>19</sup> Policy on the Development of Special Economic Zones in South Africa, 2012, p v.

<sup>20</sup> Ibid. 1.

<sup>21</sup> Annexure D of the Revised Kyoto Convention of the World Customs Organization, ch 2.

required to attain the host countries' specific goals. SEZs are generally characterised as the following:<sup>22</sup>

- Industrial parks that have been designated by a government to provide tax and other incentives to export firms.
- Labour intensive manufacturing centres that involve the import of raw material or components and the export of factory products.
- Areas that allow for normal trade barriers, such as tariffs and quotas, to be eliminated and bureaucratic requirements to be lowered to attract new business and foreign investments.
- Geographically delimited areas usually physically secured or fenced in.

The modern SEZs have been around for approximately 50 years, with Puerto Rico and Ireland being among the first countries to have established SEZs. The development of SEZs has helped improve global trade relations and has created hundreds of billions of dollars in trade revenue.<sup>23</sup> Over the past two decades, the world has seen dramatic changes in the way in which these zones have been conceived, developed, managed, regulated and governed. These changes include the growing prominence of private sector developed and run zones, the use of public-private partnerships for zone development, the implementation of World Trade Organization (WTO) compliant policy and incentive frameworks, and innovative regulatory frameworks.<sup>24</sup>

The fact that SEZs have been around for quite some time has given governments enough resources to study what makes SEZs successful and what makes them fail. Probably the clearest lesson learnt from zone development is that zones cannot and should not be viewed as a substitute for a country's larger trade and investment reform efforts;

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<sup>22</sup> A Erasmus "Trade zones: Recommendations for South Africa" SAIIA Occasional Paper No 90 (August 2011) 5.

<sup>23</sup> Engman et al. (2007) 29.

<sup>24</sup> FIAS (2008) 7.

they are merely one tool in a portfolio of mechanisms commonly employed to create jobs, generate exports and attract foreign investment, through the provision of incentives, streamlined procedures and custom-built infrastructure.<sup>25</sup>

## **2.2 Types of Special Economic Zone**

SEZ is a term used to classify a diverse number of specialised industries generally within the broad framework of the SEZ concept. There are various types of SEZs which accommodate a wide spectrum of working conditions, country infrastructure, government oversight and geography.<sup>26</sup> It is therefore essential that the right type of SEZ should be established within the right geographical area. What follows will be an outline of the different types of SEZ and their functions.<sup>27</sup>

### **2.2.1 Free Trade Zone**

Free trade zones (FTZ) are the most commonly used SEZ, and are generally characterised as being a geographically fenced-in, tax-free area that provides warehousing, storage and distribution facilities for trade, shipping and import/export operations in a reduced regulatory environment, meaning they generally have less stringent customs controls and sometimes fewer labour and environmental controls.<sup>28</sup> These zones generally focus on the tangible operations of international trade. Because many SEZs attract labour-intensive manufacturing such as assembly-oriented production of apparel, textiles and electrical goods, FTZs are a very popular type of SEZ.<sup>29</sup>

### **2.2.2 Export Processing Zone**

Export processing zones (EPZ) are similar to FTZs in that they encompass land estates that focus on foreign exports, but they differ in that they do not provide the same degree of tax benefits or regulatory

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<sup>25</sup> FIAS (2008) 5.

<sup>26</sup> Murray (2010). 1–3.

<sup>27</sup> Ibid.

<sup>28</sup> Ibid.

<sup>29</sup> FIAS (2008) 10.

leniency.<sup>30</sup> Instead, they provide a functional advantage to investors seeking to capitalise on the economies of scale that a geographic concentration of production and manufacturing can bring to a trade region.<sup>31</sup> If they are successful, these zones are beneficial to a host country because the host country does not have to provide reduced tariffs or regulations but it still benefits from increased trade to the region.<sup>32</sup>

### **2.2.3 Enterprise Zones**

What makes enterprise zones so unique is that, apart from providing manufacturing or production benefits like other SEZs, they also provide the benefits of local, centralised development efforts. They are generally created by national or local governments to revitalise or gentrify a distressed urban area.<sup>33</sup> These zones use greater economic incentives than EPZs, like tax incentives and financial assistance, to revitalise an area by bringing trade into the zone that will spur organic, localised development and improve local inhabitants' quality of life.<sup>34</sup> The implementation of enterprise zones follows the philosophy that improvement of a region's industry and trade begins at the individual neighbourhood level.

### **2.2.4 Single Factories**

Single factories are a special type of SEZ that are not geographically delineated, meaning they do not have to locate within a designated zone to receive trade incentives.<sup>35</sup> This type of SEZ focuses on the development of a particular type of factory or enterprise, regardless of location. When a country decides to establish a single factory as a type of SEZ, its intention is to create specialisation in a specific industry. A country that desires to create an export concentration in a specific

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<sup>30</sup> Murray (2010) 1–3.

<sup>31</sup> Ibid.

<sup>32</sup> FIAS (2008) 10.

<sup>33</sup> Ibid. 11.

<sup>34</sup> Murray (2010) 1–3.

<sup>35</sup> FIAS (2008) 11.

industry would use a single-factory model to promote trade and growth in just that industry, giving each factory specialising in that trade economic incentives.<sup>36</sup>

### **2.2.5 Freeport's**

Freeport's are typically expansive zones that encompass many different goods and service-related trade activities such as travel, tourism and retail sales.<sup>37</sup> Because of the variation of products and services available to a freeport, they are generally regarded as being more integrated with the host country's economy. Movements of these imported goods from the freeport to a non-free trade area in the country are subject to import duties.<sup>38</sup>

### **2.2.6 Specialised Zones**

Specialised Zones have been established to promote highly technical products and services unique to an industry.<sup>39</sup> Many of these zones focus on the production and promotion of science and technology parks, petrochemical zones, highly technical logistics and warehousing sites, and airport-based economies.<sup>40</sup>

### **2.2.7 Industrial Parks**

Industrial parks are facilities (buildings) that are set aside for production and business services in order to attract new businesses by providing integrated infrastructure in one location and localised environmental controls that are specific to the needs of an industrial area.<sup>41</sup>

### **2.2.8 Spatial Development Corridors**

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<sup>36</sup> Murray (2010) 1–3.

<sup>37</sup> FIAS (2008) 10.

<sup>38</sup> Murray (2010) 1–3.

<sup>39</sup> Ibid.

<sup>40</sup> Ibid.

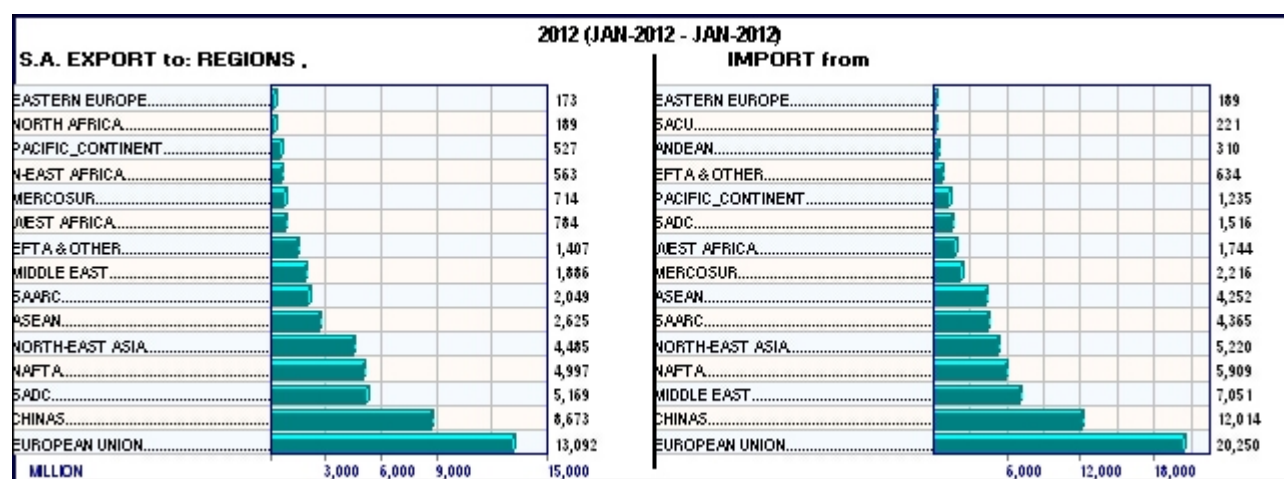
<sup>41</sup> Policy on the Development of Special Economic Zones in South Africa (2012) 2.

Spatial development corridors connect two or more economic nodes by means of transportation networks, and accommodate various economic activities along the corridors.<sup>42</sup>

### 2.2.9 Industrial Development Zones

An industrial development zone is a purpose-built industrial estate linked to an airport or sea port that leverages domestic and foreign fixed direct investments in value-added and export-oriented manufacturing industries and services.<sup>43</sup>

## 2.3 Trade Zones in Other Jurisdictions



South Africa's major trading partners are Europe, the United States (US), Latin America, India and China.<sup>44</sup> South Africa has formal trade relations with most of these territories by way of generalised systems of preferences (GSP), for example GSP with the US and the extension thereof through the African Growth and Opportunity Act, and free trade agreements with the EU, the European Free Trade Association and the Southern African Development Community.<sup>45</sup> South Africa has also been in discussions with the US, India and China regarding preferential

<sup>42</sup> Ibid.

<sup>43</sup> Ibid. 3.

<sup>44</sup> The DTI Website available at: <http://apps.thedti.gov.za/econdb/raportt/rapregi.html> (accessed April 2012)

<sup>45</sup> Erasmus (2011) 7.

trade agreements (PTAs) and discussions with Mercosur (Common Market of the South) have led to a PTA that is yet to enter into force.<sup>46</sup>

The following section emphasises the composition and functions of SEZs in the five major jurisdictions (the European Union, the US, Mercosur, India and China), given that South Africa needs to compete with and, in some cases, offer preferential rates to goods manufactured in trade zones within these territories.

### **2.3.1 The European Union**

SEZs are special areas within the customs territory of the European Community (EC) provided for under EC law. The primary function of SEZs includes:<sup>47</sup>

- i. The provision of a service to traders to facilitate trading procedures by allowing fewer customs formalities.
- ii. Goods placed within these areas are free from import duties, VAT and other import charges.
- iii. Goods for export can also be placed in SEZs to allow for VAT zero rating.
- iv. There may be special reliefs available in SEZs from other taxes, excises or local duties, which will differ from one zone to another.

Shannon Free Zone in Shannon, Ireland, being the first SEZ to be implemented in the modern world, was established in 1959 in an attempt by the Irish government to promote employment in a rural area, making use of a small regional airport, and to generate revenue for the Irish economy.<sup>48</sup> In all, 110 overseas companies have invested in the Shannon Free Zone, employing 6 500 workers with trade valued at

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<sup>46</sup> Ibid.

<sup>47</sup> Ibid. 8.

<sup>48</sup> Engman et al. (2007) 11.



approximately three billion Euros per year.<sup>49</sup> Ireland also has a second SEZ at Ringaskiddy. There are currently five FZs in the UK:<sup>50</sup> the Isle of Man, Liverpool, Prestwick (Ayrshire, Scotland), Sheerness (Kent) and Tilbury (Essex). There are no special reliefs in UK SEZs from other taxes, excise duties or local authority rates.<sup>51</sup> France's SEZs are located at the port of Bordeaux Le Verdon and Franche de Guyane in French Guiana. Germany has three SEZs, namely, Bremerhaven, Cuxhaven and Hamburg. Italy has two SEZs in Trieste and Venice. Indeed, there are SEZs in all EC countries except for Austria, Belgium, Lithuania, Luxembourg, Slovakia and Sweden.<sup>52</sup>

Some of the benefits of using FTZs include the following:<sup>53</sup>

- i. There is improved cash flow management by removing the obligations to pay VAT or import duty at the same time as goods are physically transported into the SEZ.
- ii. SEZ facilities are similar to customs warehouses. Goods brought from outside the EC and held in an SEZ are treated as being outside the customs territory of the EC, even though they are physically within it.
- iii. Import VAT on goods is suspended in SEZs. Traders pay VAT when the goods are removed from the SEZ. In addition, import duties are suspended provided the goods are not released for free circulation. Excise is also suspended until the goods are released to the EU market or used in the SEZ.

### **2.3.2 The United States**

The US has close to 277 FTZs,<sup>54</sup> which are all licensed by the US Foreign Trade Zones Board and operated under the supervision of the

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<sup>49</sup> Shannon Development "Invest in Shannon, Ireland", available at: <http://www.shannonireland.com> (accessed 1 February 2012).

<sup>50</sup> Erasmus (2011) 8.

<sup>51</sup> Ibid. 9.

<sup>52</sup> Ibid. 7.

<sup>53</sup> Ibid. 8.

US Customs Service.<sup>55</sup> FTZs are special commercial and industrial areas in or near ports of entry where foreign and domestic merchandise, including raw materials, components and finished goods, are brought in without being subject to the payment of customs duties.<sup>56</sup> Inside these zones merchandise may be sorted, sold, exhibited, repacked, assembled, stored, graded, cleaned or otherwise manipulated before goods are exported or goods enter into the national customs territory.

US FTZs offer the following benefits:<sup>57</sup>

- i. Duty exemption, there is no duty or quota charges on re-exports.
- ii. Customs duties and federal excise tax are deferred on imports. In situations where zone manufacturing results in a finished product that has a lower duty rate than the rates on foreign inputs (inverted tariff), the finished product may be entered at the duty rate that applies to its condition as it leaves the zone, subject to public interest considerations.
- iii. Companies using FTZ procedures may have access to streamlined customs procedures. Foreign goods and domestic goods held for export are exempt from state/local inventory taxes.
- iv. FTZ status may also make a site eligible for state/local benefits that are unrelated to the US FTZ Act.

### **2.3.3 Mercosur**

The Latin American Free Trade Association was created in the 1960 Treaty of Montevideo by Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay.<sup>58</sup> The Southern Common Market of South America

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<sup>54</sup> Import administration, US Department of Commerce, “US foreign trade zones” Available at: <http://ia.ita.doc.gov/ftzpage/letters/fizlist-map.html> (accessed February 2012).

<sup>55</sup> Erasmus 2011 p 9.

<sup>56</sup> Ibid.

<sup>57</sup> Ibid.

<sup>58</sup> Wikipedia, “free trade zone” Available at: [http://wikipedia.org/wikki/Export\\_Processing\\_Zones](http://wikipedia.org/wikki/Export_Processing_Zones). (Accessed February 2012).

was founded in 1991 by the Treaty of Asuncion and later amended by the 1994 Treaty of Ouro Preto.<sup>59</sup> Mercosur is a customs union between Argentina, Brazil, Paraguay and Uruguay. Paraguay, Brazil and Argentina have similar legislation to Uruguay, since it is based on legislation applicable to the whole of Mercosur. What follows is a discussion on the workings of SEZs within Uruguay, which currently has 12 SEZs.

In terms of legislation passed in 1987, Uruguayan FTZs are areas that are isolated from the rest of the national territory, where economic activity is stimulated by specific legislation.<sup>60</sup> These zones grant customs and tax exemptions, and they also exclude state monopolies. Goods from within these zones are treated as imports into non-zone areas, where the importer is then required to pay all the applicable import duties and taxes. The same goes for goods exported from non-zone areas to within the zone. These zones can be administered by either the government or by a duly authorised private company. Companies located within these zones (FTZ tenants) must employ a minimum of 75% Uruguayan employees.

All goods and services introduced into/allowed to exit the FTZ are exempt from customs import/export fees and taxes generated from such transactions. Customs exemptions are related to the activity, that is, they are applied in all cases, regardless of whether the buyer is an FTZ tenant.<sup>61</sup> Such tenants are exempt from every domestic tax, including gains tax, equity tax and personnel income tax.<sup>62</sup>

The circulation of all types of currency and the payment or collection of funds generated by purchases or sales negotiated in the FTZs does not require the intervention of the Uruguayan economic authorities, and the repatriation of capital and interest is free.<sup>63</sup> However, any goods

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<sup>59</sup> Erasmus (2011) 10.

<sup>60</sup> Ibid.

<sup>61</sup> Ibid.

<sup>62</sup> Ibid.

<sup>63</sup> Ibid.

exported to a member country pay the customs duty applicable at the time of importation. Therefore, customs duties are applicable to the whole finished product.

#### **2.3.4 India**

India's first SEZ was established in Kandla in 1965. After realising the effectiveness of SEZs, India introduced its own SEZ policy in April 2000.<sup>64</sup> India's 130 SEZs aim to generate additional economic activity, promote exports of goods and services, promote investment from domestic and foreign sources, create employment opportunities and develop infrastructure facilities.<sup>65</sup> By March 2005, 811 companies were operating in eight functional SEZs, generating INR<sup>66</sup> 18,3 billion (US\$ 0,4 billion) in exports and providing employment for 100 650 workers of which one-third were woman.<sup>67</sup> Given these rather modest results, the Special Economic Zones Act of 2005 was enacted in February 2006 and it has triggered a rush to establish new SEZs. By September 2006, 181 new zones had been approved and another 200 applications were pending.<sup>68</sup>

The incentives and facilities offered in SEZs to attract investment include the following:<sup>69</sup>

- i. Duty free import/domestic procurement of goods for the development, operation and maintenance of SEZ units
- ii. 100% income tax exemption on export income for the first five years, 50% for the next five years, and 50% of the reinvested export profit for the five years thereafter

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<sup>64</sup> Government of India, "Special economic zones in India". Available at: <http://sezindia.nic.in/index.asp>. (accessed February 2012)

<sup>65</sup> Erasmus (2011) 11.

<sup>66</sup> Indian rupees.

<sup>67</sup> Engman et al. (2007) 18.

<sup>68</sup> Ibid.

<sup>69</sup> Erasmus (2011) 11.

- iii. Exemption from minimum alternate tax, central and state sales tax and service tax
- iv. External commercial borrowing by SEZ units of up to \$500 million a year without any maturity restriction through recognised banking channels and single-window clearance for central and state-level approvals.

### **2.3.5 China**

China's first SEZ was established in 1979; by 2007, 30 million people were working in more than 200 EPZs in China.<sup>70</sup> China started out with four SEZs in Shenzhen, Zhuhai, Shantou and Xiamen in 1980 and these later expanded to 14. In 1985, the entire Hainan Province became the fifth SEZ. In the same year, the following regions also became SEZs: Yangzi River Delta, Pearl River Delta, Southern Fujian Delta, Shandong Peninsula, Liaodong Peninsula, Heibei Province and Guangxi Province.<sup>71</sup>

By 1992 China had just over 60 SEZs. Apart from the earliest four, China's SEZs are more jurisdictional than physical zones. Chinese developments, also referred to as "new districts", are SEZs built inside the main cities. These development zones are divided into six main types:<sup>72</sup>

- i. Economic and technology development zones
- ii. High-tech industrial development zones
- iii. Border cooperation zones
- iv. Boundary zones or logistics parks
- v. Export processing zones and industrial parks
- vi. Investment zones

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<sup>70</sup> Ibid. 12.

<sup>71</sup> Ibid.

<sup>72</sup> Ibid.

The Waigaoqiao free trade zone (WFTZ), established in 1990, is one of the oldest and largest of China's FTZs. It is located in Shanghai and offers the following incentives:<sup>73</sup>

- i. Companies operating in the WFTZ are exempted from payment of customs duties and VAT on the importation of raw materials, machinery, manufacturing components and office equipment. This exemption does not apply to raw materials and components imported for use in products to be sold domestically.
- ii. Imported goods can be stored within the WFTZ, and simple processing is permitted.
- iii. The WFTZ is the only place in China where foreign exchange values may be fully retained. Foreign funded companies operating in the WFTZ are entitled to conduct international trading, manufacturing, processing, warehousing, logistics and exhibition of bonded commodities.
- iv. Foreign funded companies are also entitled to conduct trade-related services, such as testing and maintenance.
- v. Foreign companies investing in the WFTZ zone may enjoy government preferential tax treatment and special subsidies from the Shanghai Municipality and the Pudong New Area Government.

## **2.4 Conclusion**

SEZs are a phenomenon that is encountered across the globe in a wide variety of models. Countries establish these economic development programmes for various reasons, but mainly for the purpose of attracting FDI, the development of underdeveloped regions and to generate employment as well as revenue. As seen above, every major economy implements these zones one way or another. Therefore, why should South Africa not benefit from these zones? There is no one clear

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<sup>73</sup> Ibid. 10.

solution to solving a country's economic problems, but SEZs may be a useful tool for helping countries to successfully achieve their overall economic development strategy.

## Chapter 3

### An Overview of South African Special Economic Zones

#### 3.1 An Introduction to Special Economic Zones in South Africa

After the 1994 elections, the new democratic government had to deal with various economic development challenges, including raising the levels of domestic and FDI, generating employment and increasing international participation. On 1 December 2000, the South African government launched its very own IDZ programme which led to the demarcation of the following industrial development zones:

- Richards Bay IDZ in Richards Bay, Kwazulu-Natal
- East London IDZ in East London, Eastern Cape
- Coega IDZ in Port Elizabeth, Eastern Cape
- Oliver Tambo International Airport IDZ in Kempton Park, Gauteng<sup>74</sup>

Globalisation has forced South Africa to reposition itself in the world economy and it is for this reason that the South African government introduced the Industrial Development Zone Programme in 2000 through the Manufacturing Development Act.<sup>75</sup> The main objective of this programme was to focus on attracting FDI and to promote the export of value-added commodities. The problem with the implementation of these zones was that they were limited to certain geographical jurisdictions. For example, these zones could only be designated adjacent to a sea port or international airport, which excluded other regions of the country that had industrial potential but did not meet the IDZ criteria. This limitation subsequently provided the rationale for a more inclusive industrial facilitation model in the

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<sup>74</sup> Erasmus (2011) 5.

<sup>75</sup> No 187 of 1993



form of the Special Economic Zone Programme which will utilise a wide range of instruments.<sup>76</sup>

In January 2012, Rob Davies, the South African Minister of Trade and Industry, announced the intention of the South African government to establish special economic zones in South Africa through the implementation of the draft Special Economic Zones Bill. The overall objectives of this Bill, as stated by the Minister, are to accelerate industrial development, attract foreign and domestic investment, unlock regional economic development, broaden access to economic opportunities by previously marginalised citizens and regions, create more quality jobs, and improve the general living standards of South Africans.<sup>77</sup>

This new initiative aims to improve on the concept of industrial development zones (IDZs) which have enjoyed mixed success since being introduced in December 2000 through the Manufacturing Development Act.<sup>78</sup> To enhance South Africa's national and international competitiveness, it is important and necessary to continue improving on and restructuring existing laws, so as to reflect social and economic changes.

### **3.2 Background on the Industrial Development Zones**

Prior to the draft SEZ Policy and the Bill, in 2000 the DTI initiated the Industrial Development Zones Programme. Notwithstanding the geographical shortcoming of these zones, government still intended to use these zones to support industrial development in the host regions with a special focus on export-oriented value-added manufacturing. Therefore, the designating of IDZs to either an international sea port or airport led to the establishment of the following four IDZs, namely,

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<sup>76</sup> Policy on the Development of Special Economic Zones in South Africa (2012) v.

<sup>77</sup> "Minister Davies gazettes Special Economic Zones Bill for public comment" 17 January 2012. Available at: <http://www.dti.gov.za/editmedia.jsp?id=2318> (accessed 31 January 2012).

<sup>78</sup> Tralac "special economic zones for South Africa" 18 January 2012 Available at: <http://www.tralac.org/2012/01/18/special-economic-zones-for-south-africa/> (accessed 31 January 2012).

Coega in Port Elizabeth, East London, Richards Bay and the OR Tambo International Airport. These are now operational with the exception of the OR Tambo International Airport IDZ.<sup>79</sup> The achievements of the IDZ Programme include a total of 40 investors attracted into the IDZs with more than R11,8 billion investments generated and more than 33 000 jobs (both in construction and direct) created.<sup>80</sup> Despite these achievements, the government believes that more could have been achieved. A review of the IDZ Programme was then initiated, and this identified some challenges that needed to be addressed.

### **3.3 Challenges with Regard to the Current Independent Development Zone Programme<sup>81</sup>**

#### **i. Design challenges**

The most fundamental design flaw of the current IDZ Programme relates to the fact that the programme focused exclusively on only one type of SEZ to the exclusion of the others. As stated above, there are various types of SEZs that can be used; hence, restricting oneself to just one type creates a situation where the benefits of the other types of SEZ cannot be harnessed. In terms of the IDZ Programme, only those regions that had access to an international airport or sea port, could qualify for support.

#### **ii. Nature of support**

IDZs were established to support the development of export-oriented industries. Therefore, what was required was that the industrial development of these zones, as well as the host regions, should be able to support the long-term development of those industries. Successful SEZ programmes tend to focus on the provision of various support structures, which include infrastructure, skills development, technology, research and development, market support, finance, market

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<sup>79</sup> D Brand *An Evaluative Analysis of Industrial Development Zones and Export Processing Zones with Reference to the Coega Industrial Development Zone*, (2002) 31.

<sup>80</sup> Policy on the Development of Special Economic Zones in South Africa (2012) 3.

<sup>81</sup> Ibid. 9–12.

access, logistics, and incubation programmes. These support packages make an important contribution in the creation of successful SEZ programmes. In terms of the IDZ Programme, not enough attention was paid to out-of-zone activities, especially those activities that are critical for the success of in-zone enterprises and the sustainability of the zone.

### **iii. Ad hoc planning arrangements**

IDZs are just one of the tools governments use for economic development. It is therefore essential that these zones be integrated into key strategies at national, provincial and regional levels. Local IDZs need to be developed in such a way that they enhance competition with SEZs in other parts of the world, and not between themselves. This requires the alignment and harmonisation of strategic plans.

### **iv. Governance arrangements**

All tiers of governments should participate in the development of IDZs. Each of these participants has different roles to play and these have to be clearly defined and delineated. The current regulatory framework lacks sufficient guidance with regard to the governance arrangements concerning IDZs, which results in insufficient or untimely oversight of the strategic plans and operations of IDZs.

### **v. Financing arrangements**

Currently, IDZs are entirely dependent on state funding for operational expenditure as well as capital expenditure. This financial dependency is subject to the availability of funds in the successive Medium-Term Expenditure Framework (MTEF) of national and provincial governments. At this stage all financing arrangements for IDZs tend to be short term and do not provide certainty for the long term, which creates uncertainty in developing long-term plans. In addition, no provision is made for development finance institution (DFI) funding, making funding arrangements very inflexible and somewhat inadequate.

#### **vi. Targeted investment**

There is a need for SEZs to be regulated by a single strategy and message in order to promote investment. Investment promotion is currently being done independently by individual IDZs and there is no structured coordination between IDZ operators and the South African Department of Trade and Industry (DTI), resulting in diverse messages being conveyed to the investment community.

#### **vii. Inadequate coordination across government agencies**

Inadequate participation by government departments and agencies involved in the implementation of the IDZ programme remains a problem. For IDZs to operate successfully and effectively, it is essential that the various government departments provide services in a coordinated manner. Inadequate participation by the various stakeholders in general will result in less than optimal servicing of these zones.

### **3.4 Rationale for a Broader Special Economic Zone Framework**

The review of the IDZ programme began in 2007 and was informed by a number of factors including the following:<sup>82</sup>

#### **i. Developments in national economic policies and strategies**

In bringing SEZs in line with the Industrial Policy Action Plan and the New Growth Path, the DTI aims to continue fostering its efforts to create employment and economic growth by establishing a strong industrial base in South Africa.<sup>83</sup> Accordingly, advancing government's strategic objectives of industrialisation, regional development and job creation through the implementation of SEZs is critical to these efforts. It should be emphasised that the new Special Economic Zone Programme will be specifically used to promote the creation of a

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<sup>82</sup> Ibid. 7.

<sup>83</sup> Ibid.

regionally diversified industrial economy by establishing new industrial hubs in the underdeveloped regions of the country.<sup>84</sup>

## **ii. Developments in global economic environment**

Since 2000, when the IDZ programme was introduced, a series of drastic changes have taken place in the world economy. These include increased competition for FDI, a shift in the global economic power balance from the west to the east, and shifts in geopolitical arrangements including the formation of BRICS<sup>85</sup> and other groupings. These changes have contributed to the emergence of new sources of FDI, new global economic power relations and new markets. Groupings such as BRICS can assist the country in attracting much desired investments and SEZs can be a useful instrument in that regard.

## **iii. Lessons learnt in the implementation of industrial development zones**

The following lessons learnt from the implementation of the IDZ programme provide valuable experience and lessons for government. Accordingly, they need to be factored into other efforts in order to attract foreign and domestic direct investment:<sup>86</sup>

- The economic literature shows that SEZs are the key tool used in all the fastest growing economies, including China, India, Brazil, and others; to accelerate the development of targeted industries and attract desired foreign and domestic direct investment.
- Leadership and effective implementation may be even more important than a good policy or strategy.
- Coordination across all tiers of government and public entities is necessary to speed up implementation.

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<sup>84</sup> Ibid.

<sup>85</sup> BRICS is an economic partnership between Brazil, Russia, India, China and South Africa.

<sup>86</sup> Policy on the Development of Special Economic Zones in South Africa (2012) 8

- An SEZ is a tool for economic development and not an end in itself. It is therefore important to focus on the goal of economic or industrial development rather than just the tool.
- The potential benefits of SEZs are not automatic but depend on whether the necessary conditions are created for their success. These conditions include strong political and technical leadership, commitments over the long term, integrated development planning and sufficient resourcing.
- SEZs tend to work where the strategic investment opportunities and desired industrial capabilities are clear.
- SEZs are not necessarily permanent but are used as a development tool until an area has achieved industrial sustainability.

#### **iv. Modest performance of the programme**

When compared to programmes in countries such as China, Korea, India, Malaysia and others, the performance of South Africa's IDZ programme is fundamentally modest and falls short of the expectations of all stakeholders; it therefore requires revamping.<sup>87</sup>

#### **v. To serve as pressure valves to alleviate growing unemployment**

The SEZ programmes of Tunisia and the Dominican Republic are frequently cited as examples of robust, job-creating programmes that have remained enclaves with few linkages to their host economies.<sup>88</sup>

#### **vi. As experimental laboratories for the application of new policies and approaches**

China's freeports are classic examples of this category. Financial, legal, labour and even pricing policies are introduced and tested first within the freeports before being extended to the rest of the economy.

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<sup>87</sup> Ibid.

<sup>88</sup> FIAS (2008) 12.

### **3.5 Transitional Arrangements for the Industrial Development Zones**

There are measures in place that will allow for a smooth transition for the IDZs to be incorporated as part of the SEZ programme and legislation, outside of the Manufacturing Development Act No. 187 of 1993.<sup>89</sup>

### **3.6 Special economic zones under the draft Special Economic Zones Bill, 2011**

The draft SEZ Bill will enable government to implement a broader variety of SEZs. The key provisions of the Bill include the following:

- i. The establishment of a Special Economic Zones Board to advise the Minister of Trade and Industry (hereafter referred to as “the Minister”) on the policy, strategy and other related matters
- ii. The establishment of a Special Economic Zones Fund to provide for a more coherent and predictable funding framework that enables long-term planning
- iii. The strengthening of governance arrangements including clarification of the roles and responsibilities of key stakeholders

Together with the draft Special Economic Zones Bill, the Special Economic Zones Policy has been introduced to provide a clear policy framework with respect to the development, operations and management of SEZs.<sup>90</sup>

The preamble to the new draft Bill states that the main purpose of this Bill is to

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<sup>89</sup> Policy on the Development of Special Economic Zones in South Africa (2012) 14.

<sup>90</sup> However, government has not yet published the proposed regulations. Until this draft SEZ Bill has been adopted by parliament, investors will be left in the dark about the key regulations that apply.

... provide for the designation, development, promotion and management of Special Economic Zones; to provide for the establishment of the Special Economic Zones Board; to regulate the application and issuing of Special Economic Zones operator permits; to provide for the establishment of the Special Economic Zones Fund and to provide for matters incidental thereto.<sup>91</sup>

In the following section some of the key sections of the draft Special Economic Zones Bill will be discussed.

### **3.6.1 Objectives**

The objectives of this Act are:<sup>92</sup>

- a) “To provide for the determination of Special Economic Zones policy and strategy;
- b) To provide for the designation, development, promotion, operation and management of Special Economic Zones;
- c) To provide for the establishment of the Special Economic Zones Fund to support the development of Special Economic Zones;
- d) To provide for regulatory measures and tax and business incentives for Special Economic Zones in order to attract domestic and foreign direct investment; and
- e) To provide for simplified procedures for the development and operation of Special Economic Zones and for setting up and conducting business in Special Economic Zones by providing a single window clearance facility that delivers the required government services to businesses operating in Special Economic Zones.”

### **3.6.2 Special Economic Zones Board**

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<sup>91</sup> Preamble to the draft Special Economic Zones Bill (2011) 1.

<sup>92</sup> S 2(a)–(e) of the draft Special Economic Zones Bill (2011).



The Special Economic Zones Board, which has been established as a non-executive Board for which members are appointed by the Minister, consists of the following:<sup>93</sup>

- a) A chairperson designated by the Minister<sup>94</sup>
- b) One representative from the Department
- c) South African Revenue Service
- d) National Treasury
- e) Department responsible for economic development
- f) Transnet SOC Limited
- g) Eskom SOC Limited
- h) National Planning Commission
- i) Five independent experts<sup>95</sup>

The function of the Board is to advise the Minister on policy and strategy to promote, develop, operate and manage SEZs.<sup>96</sup>

### **3.6.3 Special Economic Zones Policy and Strategy**

The Minister must determine policy for the designation, development, promotion, operation and management of SEZs after considering the advice of the Special Economic Zones Board, which, in turn, must monitor the implementation of the policy and report to the Minister on an annual basis.<sup>97</sup> This policy must be reviewed by the Minister every five years.<sup>98</sup>

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<sup>93</sup> S 4 of the draft Special Economic Zones Bill, 2011.

<sup>94</sup> A recommendation here would be that the proposed chairperson be a neutral figure who would be able to negotiate possible conflict between government departments.

<sup>95</sup> The private sector should be included.

<sup>96</sup> S 8 of the draft Special Economic Zones Bill, 2011.

<sup>97</sup> S 16(1)–(2) of the draft Special Economic Zones Bill, 2011

<sup>98</sup> S 16(3) of the draft Special Economic Zones Bill, 2011.

The Minister must also determine an SEZ strategy after considering the advice of the Special Economic Zones Board.<sup>99</sup> This strategy must address the strategic designation of SEZs and the industrial clustering that will best support industrialisation and economic growth strategies.<sup>100</sup> The Board will then monitor the implementation and report back to the Minister on an annual basis. This strategy must be reviewed by the Minister every four years.<sup>101</sup> Each SEZ must develop and implement a strategic plan within the framework of the SEZ strategy to achieve the mandate, perform the functions and comply with the conditions for that SEZ.<sup>102</sup>

#### **3.6.4 Financing and Incentives**

The Minister must, with the approval of the Minister of Finance, establish a Special Economic Zones Fund to support the promotion and development of SEZs, as well as to make regulations regarding the administration, management and criteria for the distribution of the Fund.<sup>103</sup> The Minister may also, with the approval of the Minister of any relevant government department, design and administer regulatory or other incentives or support programmes necessary to support the development and operations of SEZs.<sup>104</sup>

#### **3.6.5 Designation of Special Economic Zones**

The Minister may, after considering the recommendation of the Special Economic Zones Board, designate an area suitable for the development of an SEZ with, or without, conditions by notice in the *Government Gazette*.<sup>105</sup> National government, a provincial government, a municipality, a public entity, a municipal entity or a public–private partnership acting alone or jointly, may apply to the Minister in the

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<sup>99</sup> S 17(1) of the draft Special Economic Zones Bill, 2011.

<sup>100</sup> S 17(2) of the draft Special Economic Zones Bill, 2011.

<sup>101</sup> S 17 of the draft Special Economic Zones Bill, 2011.

<sup>102</sup> S 25 of the draft Special Economic Zones Bill, 2011.

<sup>103</sup> S 18 of the draft Special Economic Zones Bill, 2011.

<sup>104</sup> S 19 of the draft Special Economic Zones Bill, 2011.

<sup>105</sup> S 20 of the draft Special Economic Zones Bill, 2011.

prescribed form and manner for a specified area to be designated as a SEZ.<sup>106</sup> Such an application for designation must be accompanied by an application for an SEZ operator permit by the entity intended to operate the proposed SEZ.<sup>107</sup> Notwithstanding the provisions of section 22, the Minister may, after considering the recommendations of the Special Economic Zones Board and by notice in the *Government Gazette*, suspend or withdraw any designation of an area as an SEZ which does not further government's industrial development objectives, on such terms and conditions as the Minister may determine.<sup>108</sup> Upon designation as a SEZ, the applicant must –<sup>109</sup>

- a) “In the case of a national or provincial government or a public entity establish the SEZ as a national government business enterprise or a provincial government business enterprise as contemplated in Section 1 of the Public Finance Management Act, No 1 of 1999;
- b) In the case of a municipality or municipal entity establish the SEZ as a municipal entity as contemplated in section 1 of the Municipal Systems Act, No 32 of 1999; or
- c) In the case of a public-private partnership, establish the SEZ as a company.”

### **3.6.6 Special Economic Zone Operator Permit**

An SEZ may only be developed and operated by a person who holds an SEZ operator permit.<sup>110</sup> Any person wishing to develop or operate an SEZ must apply to the Minister for an SEZ operator permit in the form

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<sup>106</sup> S 21(1) of the draft Special Economic Zones Bill, 2011.

<sup>107</sup> S 21(3) of the draft Special Economic Zones Bill, 2011.

<sup>108</sup> S 23 of the draft Special Economic Zones Bill, 2011.

<sup>109</sup> S 24 of the draft Special Economic Zones Bill, 2011.

<sup>110</sup> S 28 of the draft Special Economic Zones Bill, 2011.

and manner prescribed.<sup>111</sup> An applicant for an SEZ operator permit must<sup>112</sup>

- a) “Be a South African registered company, registered specifically for the development and operation of a SEZ;<sup>113</sup>
- b) Have sufficient capital and expertise for the development, management, administration and operation of a SEZ;
- c) Submit to the Minister a comprehensive feasibility study;
- d) Indicate its ownership structure through the submission of a shareholders’ agreement, indicating shareholding, percentages of shareholding, requirements for transfer of shares and requirements for the distribution of assets upon liquidation or deregistration;
- e) Supply all required information in the prescribed form and manner; and
- f) Comply with such other criteria and required procedures as determined by the Minister from time to time.”

The functions of such an operator include that as SEZ operator must—<sup>114</sup>

- a) “Develop and implement a strategic plan for the SEZ within the framework of the Special Economic Zones strategy;
- b) Make improvements to the SEZ site and its facilities according to the plans approved by the Minister and other relevant authorities;
- c) Provide or facilitate provision of infrastructure and other services required for the SEZ to achieve its strategic and operational goals;

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<sup>111</sup> S 29 of the draft Special Economic Zones Bill, 2011.

<sup>112</sup> S 30 of the draft Special Economic Zones Bill, 2011.

<sup>113</sup> Applicant should be open to foreign companies if the company is registered in South Africa.

<sup>114</sup> S 31 of the draft Special Economic Zones Bill, 2011.

- d) Provide adequate enclosures to segregate the zone area from any applicable customs territory for the protection of revenue together with suitable provisions for the movement of persons, conveyances, vessels and goods entering and leaving the zones;
- e) Provide adequate security on the site, offices and all facilities of the zone;
- f) Adopt rules and regulations for businesses within the zone in order to promote its safe and efficient operation;
- g) Maintain adequate and proper accounts and other records in relation to its business and report in the prescribed manner or as required on zone activities, performance and development to the Minister, South African Revenue Services, the South African Reserve bank, Statistics South Africa or other relative authorities;
- h) Promote the relevant SEZ as a foreign and domestic direct investment destination;
- i) Undertake any other activity within the scope of this Act to promote the effective functioning of the SEZ; and
- j) Facilitate a single window clearance facility that delivers the required government services to business operating in the Special Economic Zone in order to provide simplified procedures for the development, and operation of the Special Economic Zone and for setting up and conducting business in the SEZ.”

An SEZ operator permit must -<sup>115</sup>

- a) “Stipulate the duties, terms and conditions for the development and operation of the SEZ by the Special Economic Zone operator, including:

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<sup>115</sup> S 32 of the draft Special Economic Zones Bill, 2011.

- I. The requirements and timetable for the planning, construction, supply of infrastructure and utilities within the SEZ;
  - II. The security measures that the SEZ operator must install and maintain in or around the customs controlled area;
  - III. The facilities that the SEZ operator must provide to enable the Special Economic Zones Board to exercise its functions within the SEZ;
  - IV. The duration of the SEZ operator permit;
  - V. The date by which the SEZ operator must exercise any option to buy or lease land in the SEZ;
  - VI. The construction timetable and milestone schedule; and
- b) Stipulate any special requirements or conditions that the minister may impose upon the SEZ operator.”

The Minister may withdraw or suspend an SEZ operator permit if the SEZ operator –

- a. “Fails to comply with the duties, terms and conditions of the Special Economic Zone operator permit;
- b. Contravenes the provisions of this Act or any law of the Republic;
- c. Contravenes or fails to comply with the customs and excise rules and procedures that are applicable to it, and the Commissioner of the South African Revenue Services notifies the Minister accordingly; or
- d. Requests the Minister to withdraw the Special Economic Zone operator permit.”

### 3.6.7 General Provisions

Any designation of an industrial development zone under the IDZ Regulations that is in force at the commencement of this Act, remains in force and must be regarded as a designation of an SEZ under this Act.<sup>116</sup> Any IDZ operator permit issued under the IDZ Regulations that is in force at the commencement of this Act, remains in force and must be regarded as an SEZ operator permit issued under this Act.<sup>117</sup> Any application for the designation of an IDZ or for the issuing of an SEZ operator permit made under the IDZ Regulations that is not finalised on commencement of this Act, must be continued and dealt with as an application for the designation of an SEZ or an application for an SEZ operator permit as the case may be under this Act.<sup>118</sup> The Minister may further, after consultation with the Special Economic Zones Board, make regulations, not inconsistent with the provisions of this Act, regarding any matter which in terms of this Act is required or permitted to be prescribed and, generally, regarding any matter in respect of which the Minister deems it necessary or expedient to make regulations in order to achieve the objectives of this Act.<sup>119</sup>

### 3.6.8 Governance of Special Economic Zones

Effective governance of SEZs is necessary to ensure the following<sup>120</sup>

- Effective guidance for the development and implementation of strategic and operational plans.
- Transparency and accountability in the use of public resources.
- Responsible execution of mandates at all levels and phases.
- Clarity with respect to the roles of the different role players.

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<sup>116</sup> S 35(2) of the draft Special Economic Zones Bill, 2011.

<sup>117</sup> S 35(3) of the draft Special Economic Zones Bill, 2011.

<sup>118</sup> S 35(3) of the draft Special Economic Zones Bill, 2011.

<sup>119</sup> S 37 of the draft Special Economic Zones Bill, 2011.

<sup>120</sup> Policy on the Development of Special Economic Zones in South Africa (2012) 16.

- Promotion of coordination across all tiers of government, as well as cooperation among all critical agencies.

Provisions with regard to governance include the following:<sup>121</sup>

- Provision is made only for public entities such as national government departments, provinces and municipalities to apply for the establishment and development of SEZs.
- The developer of an SEZ can appoint any public or private entity as the operator of the SEZ.
- The provincial Member of the Executive Council responsible for economic development or the relevant executive mayor shall assume oversight and accountability for the operations of the relevant SEZ.
- Measures shall be taken to promote effective participation of all three tiers of government, including public entities in the development and operations of SEZs.

### **3.7 South African Incentive Programme**

The following SARS offerings are available to Customs Controlled Areas (CCA)<sup>122</sup> enterprises:

- i. Relief from customs duties at time of importation into CCA:<sup>123</sup>
  - Any goods for storage
  - Raw material for manufacturing
  - Machinery used in the manufacturing process
- ii. Simplified customs procedures which include:<sup>124</sup>

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<sup>121</sup> Ibid.

<sup>122</sup> S 21A (1) of the Customs and Excise Act, 1964 (Act 91 of 1964) defines a customs controlled area (CCA) as area within an IDZ, designated by the Commissioner in concurrence with the Director General: Trade and Industry, which is controlled by the commissioner.

<sup>123</sup> SARS Website Available at: <http://www.sars.gov.za/home.asp?pid=44747> (Accessed April 2012).



- Clearance of goods – importation, exportation and transit
  - Application for designation, licensing and registration
  - Release of cargo
  - Consideration of stage consignments if the requirements are met
  - Consideration of release under embargo
  - Lesser amounts for security – licensing, registration and movement of bonded goods
- iii. Fiscal incentives on goods when<sup>125</sup>
- goods are imported for storage
  - raw material is imported for manufacturing
  - machinery is imported for use in the manufacturing process or
  - any material imported for use in the construction of the CCA infrastructure
  - goods are exported from the CCA to a foreign country
  - any services are rendered to a or in the CCA.
- iv. Subsidised infrastructure:<sup>126</sup>
- No import duties payable on goods imported for use in the construction and maintenance of the infrastructure of a CCA in an IDZ
  - No value-added tax shall be payable on the following:

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<sup>124</sup> SARS Website Available at: <http://www.sars.gov.za/home.asp?pid=44747>. Accessed April 2012.

<sup>125</sup> Ibid.

<sup>126</sup> Ibid.

- Goods imported for use in the construction and maintenance of the infrastructure of CCA
  - Land supplied to or in the CCA for sale, letting or any other agreement
  - Electricity or water supplied to the IDZ operator or CCA enterprise located in the CCA
- v. In addition to this, government should consider the following incentives for SEZ investors:<sup>127</sup>
- Easing the labour market-related requirements placed on investors
  - Infrastructure subsidies
  - Job-training subsidies
  - Wage subsidies
  - Real estate below market value
  - Cost participation
  - Incentives for transferring technology and know-how

In SEZs, support should not be only for the manufacturing industries,<sup>128</sup> but also for other services and support industries establishing

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<sup>127</sup> Erasmus (2011) 14.

<sup>128</sup> The draft Taxation Laws Amendment Bill 2011 issued on 2 June 2011 proposes enhanced deductions for projects located in an SEZ. It proposes that manufacturers that conduct greenfield projects that are located in an SEZ be able to claim a 100% deduction on the cost of manufacturing assets (55% in other areas). Those who conduct brownfield projects located in an SEZ will be able to claim a 75% deduction on manufacturing assets (35% in other areas). This will enable manufacturing companies located in SEZs to claim tax allowances of up to 200% of the cost of acquisition of manufacturing assets. Qualifying manufacturing companies will also be able to claim an additional training allowance of up to R36 000 per employee in addition to the actual cost of training employees.

themselves in SEZs.<sup>129</sup> The benefits offered can also be used to attract services industries to SEZs that are closely linked to international trade such as<sup>130</sup>

- logistic service providers
- shared services and bank office operations
- financial services
- supply chain management
- aircraft and maintenance, repair and overhaul, and leasing
- call centres

According to the South African Investor's Handbook the following incentive packages are available to each IDZ:<sup>131</sup>

- direct links to an international port or airport
- world-class infrastructure, specially designed to attract tenants
- suitability for export-oriented production
- dedicated customs support services to expedite excise inspection and clearing
- duty-free importation of production-related raw materials and inputs
- a zero rating of VAT on supplies procured from South African sources
- import status for finished goods which are sold into South Africa
- government incentive schemes

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<sup>129</sup> Erasmus (2011) 14.

<sup>130</sup> Ibid.

<sup>131</sup> South African Investor's Handbook (2010) 116.

- reduced taxation and exemption for some activities/products
- access to the latest information technology for global communications.

### **3.8 Implementation**

In order to ensure the effective implementation of the Special Economic Zones Policy, the DTI shall, in conjunction with other relevant departments and agencies, develop and implement a comprehensive SEZ programme that includes the following:<sup>132</sup>

- A national marketing strategy is required to promote all the zones internationally and domestically in order to attract the desired investments.
- A capacity building programme is required to ensure that relevant government officials across the three tiers of government, as well as senior executives of SEZs, have the necessary skills and competencies.
- Regional skills strategies have to be developed and implemented to support the short-, medium- and long-term skills needs of enterprises and industries within the zones and in the host regions.
- The key requirement for SEZs is the provision of appropriate and world class industrial infrastructure.
- Effective and efficient logistics are the lifeblood of any trade and are key to industrial development.
- Incubation programmes are critical for nurturing domestic entrepreneurs and enterprises and facilitate their integration into the key value chains in the zone and regions.

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<sup>132</sup> Policy on the Development of Special Economic Zones in South Africa (2012) 21

- Sustainable industrial development requires that appropriate measures be taken to ensure that industrialisation takes place without the destruction of the environment.
- Measures should be in place to facilitate ongoing technical innovation and access to appropriate technologies for emerging enterprises.
- Ongoing quality and productivity improvement programmes are necessary to ensure that SEZ enterprises can compete globally.

### **3.9 Conclusion**

The IDZ programme was a tool implemented by the new South African government to address economic development constraints. To a large extent credit must be given to the government for realising the shortcomings of this programme. Subsequently, the aim of the new draft SEZ Bill and Policy is to address these shortcomings. The SEZs, if implemented and managed properly, will not only help to promote greater FDI into South Africa but will also help create new employment opportunities. However, this new draft Bill is unfortunately very generic, and a lot more detail is required.

## Chapter 4

### Leveraging Special Economic Zones to Attract Foreign Direct Investment to South Africa

#### 4.1 Introduction

FDI is essential if South Africa is to increase its international and domestic competitiveness. Over 50% of FDI in South Africa originates from the European Union (EU) and its member countries, a figure that can be largely attributed to the free trade agreement between South Africa and the EU.<sup>133</sup> However, the perception still remains that Africa as a whole is not a safe investment destination. According to the United Nations Conference on Trade and Development (UNCTAD), the following basic factors in Africa make the rate of investment for both domestic and foreign investors less attractive than other developing countries:<sup>134</sup>

- Continuing civil conflicts, political crises and natural disasters, especially drought
- Small domestic markets
- Lower economic growth and even in some countries negative rates relating to other developing countries
- Poor and, in many cases, deteriorating physical infrastructure, especially telecommunications and transportation, and the lack of capital to improve it
- The high debt of African countries makes it a daunting task to manage
- Slow progress in a number of countries in introducing market and private sector-oriented economic reforms undertaken within the framework of structural adjustment programmes

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<sup>133</sup> Dippenaar (2001) 66.

<sup>134</sup> Ibid.

- Lack or low levels of skills and general technological capabilities and relatively high production costs

FDI is suggested as being crucial to the development of the South African economy because, at present, South Africa is trying to overcome scarcities of resources such as capital, entrepreneurship, access to foreign markets, efficient managerial techniques, technology transfer and innovation and employment creation.

FDI is defined as being any investment made that acquires a lasting management interest (usually of at least 10% of voting stock) and acquires at least 10% of equity shares in an enterprise operating in a country other than the home country of the investor.<sup>135</sup> South Africa defines FDI as at least 10% of the voting right or ownership of 25% or more of the total issued voting stock of the company.<sup>136</sup> The three main ways of attracting FDI are through takeovers, mergers and acquisitions (M&A) and greenfields, although this paper will focus only on greenfields investment.

#### **4.2 Some of the Factors that Make FDI successful**

The main factors that influence the successes of FDI include the mode of entry used, that is, greenfields, M&A or takeover; the activities undertaken by the investor and whether these are new or existing activities in the host country; the source of finance that is being used i.e. reinvested earnings, intra-company loans or equity capital from parent companies; and whether local physical and human resources are engaged.<sup>137</sup>

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<sup>135</sup> C North “An examination of the indirect regulation of foreign direct investment in South Africa” Mandela Institute, University of the Witwatersrand (n.d.) 2.

<sup>136</sup> Ibid.

<sup>137</sup> Ibid. 3.

If the FDI is unsuccessful it can potentially hinder the development of the host country's economy. Some of the consequences may include the following:<sup>138</sup>

- An impact on domestic competition through the suppression of local entrepreneurship and a focus on foreign skills and knowledge including worldwide contracts, advertising skills, and a range of essential support services to drive out local competitors and hinder the emergence of small scale local business
- An impact on the balance of payments which may occur if the investor imports more than can be exported resulting in trade deficits
- Instability
- Pricing of intra-firm transactions that does not reflect the true value of products entering and leaving the country and can cause a depletion of national resources
- An impact on development which can occur when the investor promotes the interests of a small number of modern-sector workers against the interests of the rest of the population by widening wage and differentials consequently causing an imbalance in the country.

### **4.3 Foreign Direct Investment in South Africa**

FDI plays an important role in any country's development and especially so in South Africa's development; nowhere was this more prevalent than during the mining boom of the 1920s to the 1970s. During this period FDI contributed significantly to the South African economy albeit at the expense of black rights. South Africa continued to attract investment during the pre-sanctions era, although investment

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<sup>138</sup> Ibid. 4.



gradually slowed in the 1980s.<sup>139</sup> From the 1980s to the 1990s the global anti-apartheid-based consumer boycott was largely imposed by transnational corporations operating in South Africa and had significant implications for the economy; for example, Barclays Bank's share of the student loan market, declined from 27% to 15% under pressure from socially and ethnically conscious clients.<sup>140</sup> Following then President PW Botha's August 1985 Rubicon speech, approximately 350 companies pulled out of South Africa.<sup>141</sup>

By the late 1990s FDI had gradually made its way back into the economy as sanctions were slowly lifted. Following the 1994 democratic elections of the African National Congress, the government immediately put into place investment-friendly policies, removing a number of the previous obstacles in place.<sup>142</sup> During this period, bilateral investment treaties (BITs) were introduced in an unprecedented number. Through the apparent desperation of the South African government to make known that it was no longer a turbulent country, but rather a safe and viable place for investments, South Africa's approach to inward and outward FDI was not informed by a holistic policy perspective but rather a patchwork of general policy considerations.<sup>143</sup>

FDI in South Africa during the last 10 years has been exceptionally erratic. Between 2000 and 2005 there was a large increase of inward FDI in dollars of 677%, followed by a large decline in 2006 of 107,93%; from 2006 to 2008 there was again an increase of 1809,4%.<sup>144</sup> While the most recent statistics for 2009 and 2010 have not yet been released it is predicted that 2009 may continue to see an increase but

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<sup>139</sup> Ibid. 7.

<sup>140</sup> Ibid.

<sup>141</sup> Ibid.

<sup>142</sup> Ibid.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

there will be a significant decrease in 2010 owing to the delayed impact of the financial crisis.<sup>145</sup>

Today, the major form of inward FDI in South Africa is through M&As, which make up 60% of transactions, whereas greenfield FDIs have an exceptionally low rate.<sup>146</sup> Most FDI inflows in South Africa are capital intensive and are directed at the already established sectors such as services and manufacturing.

South Africa is still regarded as a sound investment destination for FDI, as it has a relatively well-developed business infrastructure for motor, rail and air transport by comparison with other African countries, as well as an extensive system of brokers, financial service specialists and merchant banks.<sup>147</sup> Furthermore, it is a good transshipment point between the emerging markets of Central and South America and the newly industrialised nations of South and Far East Asia. Added to this is South Africa's accessibility to the Southern African Development Community (SADC), which consists of 15 countries containing a total population of over 180 million.<sup>148</sup> Finally, South Africa has one of the most developed sectors for specialised manufacturing areas such as gold, coal and mineral processing, and areas such as tourism, agriculture and livestock development, construction, and the service industry have seen significant development over the last 10 years.<sup>149</sup>

#### **4.4 Role of Host Country in Relation to Foreign Direct Investment**

Since the beginning of 2000 the world has seen changes in macroeconomic stabilisation, economic deregulation, large-scale privatisation programmes and the liberalisation of regulations applying to private investment and regional integration, which have largely contributed to a changing business environment that provides

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<sup>145</sup> Ibid. 8.

<sup>146</sup> Ibid.

<sup>147</sup> Ibid. 9.

<sup>148</sup> Ibid.

<sup>149</sup> Ibid.

incentives for investment decisions.<sup>150</sup> Foreign investment is normally a good indicator of potential investors' perceptions about the host country's economy and investment environment, which is largely attributed to the country's political, economic and legal environment.<sup>151</sup>

A study conducted on the IDZ in Kerala, India, identified factors that would enhance its position as an investment area for investors. These factors include:<sup>152</sup>

- Maximisation of private investment
- Elimination of restrictive labour practices
- Special legal dispensations enabling liberalised environment
- Reductions in government involvement in commercial activities
- Encouragement of private participation

#### **4.5 Special Economic Zones and Foreign Direct Investment**

According to the World Economic Processing Zones Association (WEPZA), SEZs have been the star performer in attracting investment and technology to developing countries during the past 50 years.<sup>153</sup> However, there are a number of obstacles to attracting FDI especially in the Southern African region:<sup>154</sup>

- Tax systems in Southern Africa are complex and increase the burden of full compliance.
- Red tape and bureaucratic corruption – a large number of approvals are required to proceed with FDI in Southern African countries. The process requires extensive documentation, fees,

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<sup>150</sup> GM Rich *The Development of a Strategic Management Model for Industrial Development Zones to Attract Greenfield Foreign Direct Investment* (2003) 17.

<sup>151</sup> Ibid. 19.

<sup>152</sup> Ibid.

<sup>153</sup> Ibid. 29.

<sup>154</sup> Ibid. 40.

regulatory and administrative requirements and registration procedures.

- Capital market infrastructure – lack of modernisation in capital market infrastructure tends to be a deterrent for investors wanting to invest in Southern Africa. It would seem that there is a lack of confidence in local financial institutions having the capacity to manage the risks associated with large capital inflows. Foreign investors are of the opinion that transactions through financial institutions in Southern Africa are inefficient.
- Physical infrastructure – primary infrastructure is based on the operational needs of prospective investors and includes aspects of communications, transport, electricity and existing commercial operations. Years of isolation, civil war and political unrest have resulted in Southern Africa being seen as an underdeveloped region in terms of physical infrastructure.
- Skilled labour – one motivation for FDI is to lower production costs through the utilisation of low-cost factors of production in the host country. However, it is accepted that more companies are shifting their sophisticated production lines to emerging markets where the cost and availability of skilled labour is becoming more important than the cost of labour in general. While the cost of general labour in Southern Africa is low, the availability, quality and attitude of skilled labour are poor.
- Political and macroeconomic policy stability – inflation rates and the nominal interest rates are important factors when companies look to Southern Africa for investment. The fact that Southern Africa has an unstable macroeconomic environment makes it difficult for investors to make medium- to long-term plans. This is exacerbated by an unstable political environment such as that experienced in Swaziland and Zimbabwe.

- Image and reputation – international politics dictates that once a region is formed (e.g. Southern Africa), the characteristics and past performance of all the countries in that region are associated with each other. As a result, all the countries in Southern Africa enjoy a blanket reputation and image of being war torn, corrupt and unstable.

#### **4.6 The South African Approach to Foreign Direct Investment**

The previous South African President, Thabo Mbeki, stated that South Africa has a sophisticated business environment that offers foreign investors a powerful strategic export and manufacturing platform for achieving global competitive advantage, cost reductions and new market access.<sup>155</sup>

To reaffirm the principle of partnership and shared responsibility between Africa and the international community in the industrial development of the continent, South Africa has recognised the fact that industrial development is the key element in sustainable economic growth.<sup>156</sup> Having the most advanced economy on the African continent, the country seeks to increase access to first-world markets, implement successful macroeconomic policies and become a leader and competitive producer of high-value goods among emerging markets.<sup>157</sup>

South Africa is strategically located in terms of regional and world markets. On a regional level, it provides access to countries of the Southern African Customs Union (SACU) and the Southern African Development Community (SADC); while on an international level, South Africa serves as a trans-shipment point between the emerging markets of Central and South America, the developed markets of North

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<sup>155</sup> Ibid. 64.

<sup>156</sup> Ibid.

<sup>157</sup> Ibid.

America, Europe and the Far East, and newly industrialised nations of South and East Asia.<sup>158</sup>

What makes South Africa an ideal location for FDI is its physical infrastructure. Rail, road and transportation services, advanced postal and telecommunication facilities, a well-developed electricity network and a water storage and distribution system make South Africa one of the most advanced industrial countries on the African continent.<sup>159</sup>

According to the International Trade Group, South Africa is seen as an attractive destination for FDI for the following reasons:<sup>160</sup>

- A well-diversified economy
- The most advanced, broad-based and productive economy on the African continent;
- A well-developed modern infrastructure
- A stock exchange that ranks among the top 10 to 15 in the world
- South Africa is the gateway into the rest of Africa
- Foreign investors are permitted 100% ownership of businesses in South Africa
- Above-average access to national and international markets
- Competitive cost structure in terms of labour and cost of living
- A stable government committed to political harmony and fiscal responsibility
- Attractive weather and geography

#### **4.7 Status of Industrial Development Zones in South Africa**

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<sup>158</sup> Ibid. 65.

<sup>159</sup> Ibid. 66.

<sup>160</sup> Ibid.

Four IDZs have been designated to date, but only three of these are currently operational. All three IDZs are located along the eastern coastal belt; while OR Tambo International Airport is the only inland IDZ, it is not yet operational. The four operators that were issued with IDZ operator permits by the DTI are as follows: East London IDZ Company (2007), Coega Development Corporation (2007), Richards Bay IDZ Company (2009) and OR Tambo IDZ (2010).<sup>161</sup> From 2002 to 2010, a total of 40 investors were attracted to the IDZs, with more than 11,8 billion investments generated and more than 33 000 jobs created.<sup>162</sup>

The active Industrial Development Zones that have been designated thus far can be summarised as follows:

#### **4.7.1 Coega Industrial Development Zone**

The Coega IDZ was designated in 2001 and covers a land area of 11 500 ha. It is wholly owned by the Eastern Cape province through the Eastern Cape Development Corporation and is operated by the Coega Development Corporation (Pty) Ltd.<sup>163</sup> By the end of the 2010/11 financial year, the IDZ had received a total amount of R3,6 billion from the DTI and R1,1 billion from the provincial government.<sup>164</sup> Coega IDZ has 12 on-site investors and has created 27 412 direct jobs, the majority of which are in construction.<sup>165</sup>

#### **4.7.2 East London Industrial Development Zone**

The East London IDZ was designated in 2002 and covers a land area of 420 ha. It is operated by East London IDZ (Pty) Ltd, which is co-owned by the Eastern Cape Province (76% shareholding) through the Eastern Cape Development Corporation and the Buffalo City Municipality

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<sup>161</sup> Policy on the Development of Special Economic Zones in South Africa (2012) 3.

<sup>162</sup> Ibid.

<sup>163</sup> Ibid. 5.

<sup>164</sup> Ibid.

<sup>165</sup> Ibid.

(24%).<sup>166</sup> Up to the end of the 2010/11 financial year, the East London IDZ had received a total of R1,1 billion from the DTI and R1,12 billion from the Eastern Cape Province.<sup>167</sup> The achievements of the East London IDZ include 23 on-site investors with investments estimated at R1,5 billion and an estimated total of 5 524 direct jobs (including construction jobs) created.<sup>168</sup> The automotive sector is the most developed in the IDZ and constitutes about 90% of all economic activities.<sup>169</sup>

#### **4.7.3 Richards Bay Industrial Development Zone**

The Richards Bay IDZ was designated in 2002 and covers a land area of 350 ha. It is operated by the Richards Bay IDZ (Pty) Ltd<sup>170</sup> and is co-owned by the uMhlathuze District Municipality (40%) and the KwaZulu-Natal Government (60%) through Ithala Development Finance Corporation.<sup>171</sup> By the end of the 2010/11 financial year, the Richards Bay IDZ had received a total of R88,4 million from the DTI and R205,7 million from the province.<sup>172</sup> Prioritised industrial sectors in the IDZ include aluminium, furniture, titanium, dry dock (ship repair), and the synthetic wood cluster, which currently sports one investor on site with an investment value of R650 million.<sup>173</sup>

#### **4.8 Incentives as a means of attracting foreign direct investment**

In SEZs, Incentives are offered to make up for the host economy's inherent inefficiencies, be they a protected domestic market, regulatory barriers or poor infrastructure.<sup>174</sup> An SEZ in an economy with high inherent inefficiencies may allow it to attract investors while maintaining some of these inefficiencies by providing incentives

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<sup>166</sup> Ibid.

<sup>167</sup> Ibid. 6.

<sup>168</sup> Ibid.

<sup>169</sup> Ibid

<sup>170</sup> Ibid.

<sup>171</sup> Ibid

<sup>172</sup> Ibid.

<sup>173</sup> Ibid.

<sup>174</sup> Engman et al (2007) 17.



compensating for the lower returns an investor may expect compared to other locations.<sup>175</sup> These incentives are usually time limited or tied to specific criteria, while others are intended to create a more business-friendly environment.<sup>176</sup>

The purpose of SEZs is to provide global corporations with an incentive to invest in the development and infrastructure of a foreign country through the use of a tax-friendly environment.<sup>177</sup> Tax holidays, reduced tax rates and duty-free imports are some of the benefits investors look for in an SEZ. These incentives may be permanent while other benefits are reduced over time. Not all incentives are financial in nature; procedural benefits like quicker customs processing and reduced regulatory requirements on labour and environmental policies also lure corporations to SEZs.

When a corporation chooses to locate in a SEZ location, the host country government benefits. Accordingly, a host country earns income-tax revenue, import duties and charges on zone output levels from the corporate earnings within the country, to the extent that these benefits are not completely abated. The operator, whether it is the government or a private entity or both, also earns fees on land and facility leases within the zone. Then, of course, there is the added benefit of improved infrastructure and quality of life that result from successful SEZ implementation to the economy of the surrounding region.<sup>178</sup>

Zone development also entails a wide range of financial and economic costs, including salaries of government workers in the zone authority and other operating expenses, infrastructure development outlays, import duties and charges lost from leakages of duty-free goods, and

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<sup>175</sup> Ibid.

<sup>176</sup> Ibid.

<sup>177</sup> Ibid.

<sup>178</sup> The growth of Shenzhen from a sleepy fishing village to an economic powerhouse has provided its citizens with more opportunities for employment and better access to services than the fishing village was able to provide before the establishment of the SEZ.

taxes foregone from firms relocating from the domestic customs territory to the zone.<sup>179</sup> It is important to note, however, that the government costs associated with zone development are those that are incremental and not recovered through service charges and assessments.<sup>180</sup> The high cost of infrastructure development is absorbed by a host government desperate to attract foreign investment. The government might subsidise the cost of development in order to lure a developer into the region. Therefore, before a host country approves an SEZ development, it must weigh up the benefits that a SEZ might bring to the country in trade revenues against the total cost of SEZ implementation, including the cost of construction and long-term operation.

#### **4.9 Attracting Foreign Direct Investment for South Africa**

South Africa's broad economic policy includes schemes designed to encourage and promote international competitiveness in the country's manufacturing sector. Furthermore, this is set out in government's Economic Programme of Action, whereby IDZs are cited as a means by which the country will attain increased levels of FDI in the first economy.<sup>181</sup> This will be achieved primarily through the granting of incentives to attract foreign and local investment within these zones, thereby boosting the country's economic attractiveness.<sup>182</sup>

The Organisation for Economic Co-operation and Development has identified the following tools for attracting investment to a country:<sup>183</sup>

- i. Enhanced physical infrastructure
- ii. Streamlined administrative services
- iii. Fiscal incentives

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<sup>179</sup> FIAS (2008) 32.

<sup>180</sup> Ibid.

<sup>181</sup> SARS Website Available at: <http://www.sars.gov.za/home.asp?pid=44747>. Accessed April 2012.

<sup>182</sup> Ibid.

<sup>183</sup> Engman et al (2007) 17.

- iv. Relaxed legal and regulatory requirements
- v. Export promotion services

Although the incentives currently offered by South Africa incorporate some of the possibilities listed above, South Africa has other options available that can be offered specifically to IDZs.<sup>184</sup> South Africa does not, however, have incentives that cover the following options:<sup>185</sup>

- i. Regulatory incentives offering investors derogation from labour rules and regulations to ease requirements related to the labour market, as South African labour laws are generally seen as very restrictive.
- ii. Financial incentives for relocation and expatriation and for making real estate more attractive.
- iii. Incentives for capital formation where profits are reinvested.

#### **4.10 Conclusion**

Economic progress is vital for South Africa if the country has any intention of benefitting from globalisation and liberalisation of trade. This can be achieved through the inflow of FDI into South Africa. One specific tool aimed at generating this inflow is the establishment of SEZs. As investors are only interested in a country's resources or to be close to the markets it intends to access, the provision of attractive incentives could be the motivation necessary to convince potential investors to set up shop here instead of somewhere else. Without specific incentives, South Africa's SEZs will not be able to compete with international SEZs. It would therefore seem that the general benefits of SEZs are insufficient to attract the required investment for the support and further development of South African SEZs.

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<sup>184</sup> As stated in chapter 3 of this work.

<sup>185</sup> Erasmus (2011) 14.

Accordingly, South Africa needs additional benefits to those already offered to attract investment for the SEZs. It is important that the South African government, from the outset, ensures that all incentives offered are WTO consistent; this will be discussed in more detail in the following chapter.

## Chapter 5

### The Nature and Composition of Special Economic Zones

#### 5.1 Introduction

The previous chapters set out the role, objectives and functions of SEZs, and the most important aspects of SEZ implementation will be discussed in this chapter. SEZs do work, period. If they contribute 1% to global employment, they contribute 20% to global exports.<sup>186</sup> In some countries, SEZs have been transformational while in other countries they have been utter failures. However, such failures can largely be attributed to the policy and programmatic phases of projects. It is therefore essential to, firstly, recognise upfront and properly document the obstacles that will confront a project in terms of strategy, design and implementation. Secondly, obstacles must be addressed with a sufficient degree of confidence. Thirdly, the need exist to determine whether the host country have the will, the lasting power and the capacity to implement a project such as SEZ development.

#### 5.2 Private/Public Nature of SEZs

Initially, SEZs were government-sponsored projects intended to promote foreign investment that would only benefit the country at the government level. In the 1980s, however, the first privately developed SEZs were created in the Caribbean and Central America to compete with government trade zones, which were often fraught with inefficiencies and cumbersome regulations.<sup>187</sup> More recently, about 62%<sup>188</sup> of SEZs are run by private developers seeking to capitalise on the enormous economic benefits of foreign trade and investment.<sup>189</sup> Private zones, if left unregulated, could make too many demands on infrastructure, facilities and services. For example, in the Dominican

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<sup>186</sup> C Baissac “The Purgatory of SEZ Project Initiation, Planning and Programming” (2011) 13.

<sup>187</sup> Murray (2010) 6.

<sup>188</sup> FIAS (2008) 2.

<sup>189</sup> Murray (2010) 6.

Republic, the sudden and unexpected growth of privately developed SEZs wreaked havoc on local infrastructure and prompted bans on SEZ development.<sup>190</sup> That is why it is important for SEZs to be located close to existing infrastructure and facilities in order to reduce excessive government outlays.

The vast resources available to private developers have resulted in the creation of higher-end SEZs. Private developers can also command higher rental rates because many investors prefer to locate in efficiently configured, privately run zones that have better social and environmental facilities than those of their public counterparts, which are often crowded and poorly designed, and have inadequately maintained facilities.<sup>191</sup>

Location is key and most modern zone programmes have developed in such a way as to ensure that new zone projects are located close to existing public infrastructure and facilities, thereby reducing government expenditure. Without doubt, privately operated zones tend to offer better facilities and amenities, which result in higher prices from tenants and attract higher-end types of activity. As a result, private zones have generally been more profitable and have had better social and environmental track records than public zones throughout the world (with East Asian government-run zones the notable exceptions).<sup>192</sup>

The benefits of public–private partnerships have become increasingly clear, especially in SEZ implementation, because such a joint enterprise provides the best attributes of both parties. Private investors bring coveted development expertise, contracts for private management and leasing and financing, while host country governments bring public funds for infrastructure development, local country expertise and

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<sup>190</sup> Ibid. 6.

<sup>191</sup> Ibid. 7.

<sup>192</sup> FIAS (2008) 4.

additional financial support.<sup>193</sup> Local governments also aid in assembling the large land acreage needed to create a geographically based SEZ.<sup>194</sup>

This kind of public–private partnership benefits both parties and improves the overall economic returns of the SEZ. It also creates economic and investment certainty among investors. The developer earns the right to market and use the SEZ’s tax incentives and regulatory benefits to grow its investment, while the government attracts international businesses that provide the host country with FDI revenue and investing expertise.<sup>195</sup> The following models have become increasingly popular among public–private partnerships:<sup>196</sup>

- Public provision of off-site infrastructure and facilities (utilities connections, roads) as an incentive for private funding of on-site infrastructure and facilities.
- Assembly of land parcels with secure title and development rights by the government for lease to private zone development groups, development of better land use/ownership laws and regulations and adoption of enforceable zoning and land use plans.
- Build-operate-transfer and build-own-operate approaches to on-site and off-site zone infrastructure and facilities, with government guarantees and/or financial support.
- Contracting private management for government-owned zones or lease of government zone assets by a private operator (beneficial ownership).

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<sup>193</sup> Murray (2010) 7.

<sup>194</sup> The Pomeranian Special Economic Zone is a unique SEZ development in Poland that has been created using an assemblage of public land and existing infrastructure along with new private construction by global investors.

<sup>195</sup> Murray (2010) 7.

<sup>196</sup> FIAS (2008) 2–3.

- Equity-shifting arrangements whereby a private contract manager of a government zone can exercise a purchase option once pre-defined performance levels have been reached.

### **5.3 Land Acquisition**

Displacement challenges are a very contentious issue, one which has a significant impact on any SEZ implementation. Initially, the host country or private developer must acquire the land area used, which normally is quite a large geographic area, to implement a zone. It may happen that this land is taken from locals whose livelihoods depend on the land being acquired. This acquisition generally creates the following problems:<sup>197</sup>

- i. This land may be acquired through exploitative means, causing locals to sell their lands for extremely low prices.
- ii. Farmers in these environments might make a living from subsistence farming, in which the case the land that is acquired is the farmer's sole means of food and livelihood.
- iii. Even if farmers farm for profit, some have very low skills levels that are not transferrable to more complex SEZ unit employment like manufacturing or technology-based trades. The acquisition of their land displaces them from their economic means of survival and forces them into an unfamiliar environment where they lack the skills to stay and work in the SEZ unit. If they also lack the resources to move, they are left without a farm or survival skills.

### **5.4 Environmental Implications**

As part of the overall incentive packages offered by host governments, environmental standards may be lowered to attract potential investors, or these environmental concerns may be overlooked owing to the high cost or regulation and oversight. Emission controls are regulations that

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<sup>197</sup> Murray (2010) 7.



an SEZ developer will try to avoid because they cut into SEZ profitability.

### **5.5 Social Implications**

An SEZ development can socially cannibalise its surroundings, diverting valuable resources into the SEZ that those living on the outside depend on to survive.<sup>198</sup> The creation of an SEZ development to better one sector of a country's economy at the expense of another will widen the gap between the more prosperous living within the SEZ area and the poor living outside the SEZ, hindering the true net gain of the development.<sup>199</sup>

### **5.6 Labour Implications**

Labour standards are a very contentious issue within SEZ development. Large multinational companies that wish to capitalise their investments tend to employ low-skilled, low-cost assembly-line workers. Zimbabwe and Namibia are renowned to have excluded the provisions of their nations labour Acts when they initiated national EPZ laws in the early 1990s, drawing immediate criticism from the global human rights community.<sup>200</sup>

Females originally accounted for 60 to 70% of the SEZ workforce because many companies regard women as better suited to the repetitive textile and electronic-based manufacturing industries that made up much of the initial SEZ work; however, that percentage tends to decrease as product complexity increases.<sup>201</sup> Fortunately, the International Labour Organisation standards has set standards that most countries have adopted which are critical to prevent abuses, and foreign investors have been increasingly mandating quality labour

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<sup>198</sup> Murray (2010) 7.

<sup>199</sup> Ibid.

<sup>200</sup> Ibid. 8.

<sup>201</sup> FIAS (2008) 2.

management practices as a prerequisite to doing business with a host country.<sup>202</sup>

As stated on numerous occasions, one of the main objectives in many SEZs is employment generation, which in turn can have a positive effect in the alleviation of poverty. While SEZs do not present a solution to unemployment, they are nonetheless a viable source of employment creation especially if indirect employment is also considered.<sup>203</sup> The case of SEZs in South Africa will probably not have any problem with existing labour legislation that will apply to these zones, as organised labour has been an extremely important participant in the NEDLAC arrangement, involving government, business and organised labour, and has been a key alliance partner of the ruling African National Congress.<sup>204</sup>

## **5.7 Infrastructure Investment**

Another obstacle that SEZs face is the high cost of development.<sup>205</sup> Some SEZ developments have cost the host country more to build than they bring in trade revenues, negating the benefits the trade region brings to the country; this has been referred to as a “race to the bottom”.<sup>206</sup> This kind of strategy produced a downward spiral in SEZ conditions across the continent, as Southern African countries competed with each other by promoting reduced regulations and increased economic incentives and, as a result, foreign investors reaped all the benefits of the competition while the host countries absorbed all the costs.

One of the benefits of SEZs is that they generate economic activity both inside and outside the zone. This will automatically result in an increased demand for social infrastructure like housing, education, health, and transport and communications, shopping, tourism

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<sup>202</sup> FIAS (2008) 39–41.

<sup>203</sup> Ibid. 34.

<sup>204</sup> Brand (2002) 2.

<sup>205</sup> FIAS (2008) 4.

<sup>206</sup> Ibid.

hospitality, packaging, banking and insurance, all of which combine to grow employment and improve the quality of life in and around an SEZ development.<sup>207</sup>

## **5.8 Incentive Implication**

Tax policies and fiscal incentives play a huge role in attracting potential investors. The typical package of fiscal incentives offered by SEZs almost universally include but are not limited to, corporate income tax holidays or reduced tax rates, import duty exemptions and indirect tax abatements.<sup>208</sup> SEZs tax benefits help expand a country's industrial base by luring foreign industries that might not otherwise choose to locate in the host country. Foreign direct investors doing business in a host country also improve host country facilities because one of the ways they compete for global business is through sophisticated, high tech developments and world class facilities.<sup>209</sup> These highly developed enclaves help offset the country risks that many foreign investors consider when they consider investments in foreign markets.<sup>210</sup>

## **5.9 Special Economic Zones: Policy and Trade Rules**

### **5.9.1 Introduction**

While SEZs are not specifically mentioned in any of the WTO agreements, certain incentives or subsidies that are part of SEZ policy may be covered by WTO provisions.<sup>211</sup> The Agreement on Subsidies and Countervailing Measures (SCM Agreement) is located in the section of the WTO Agreements dealing only with goods, and thus, by implication does not cover services.<sup>212</sup> The Agreement on Trade Related Investment Measures (TRIMS Agreement) may also have implications that effect

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<sup>207</sup> Murray (2010) 10.

<sup>208</sup> FIAS (2008) 34.

<sup>209</sup> Ibid.

<sup>210</sup> Ibid.

<sup>211</sup> Engman et al. (2007) 45.

<sup>212</sup> C Haywood and M Ouya "Economic Processing Zone Incentives and the WTO Agreement on Subsidies and Countervailing Measures" (2001).

SEZs. It should be stressed that all WTO Agreements (the GATT, SCM Agreement, TRIMS and GATS) apply to any measure, thus a certain subsidy or measure permissible under one agreement may raise legal issues in the context of other agreements.<sup>213</sup>

### **5.9.2 Agreement on Subsidies and Countervailing Measures**

The treatment of specific subsidies is that they may be prohibited, actionable or non-actionable, and in all cases the WTO has to be notified.<sup>214</sup> Therefore, if they are prohibited they must be eliminated. Prohibited subsidies are subsidies that are either based on export performance or subsidies contingent on the use of domestic goods over imported goods. A subsidy is actionable when it may involve a country in a dispute with another country at the WTO. Actionable subsidies make up the vast majority of specific subsidies and some countries may want to use actionable subsidies, for example if the country is a minor player in the industry. Unlike prohibited subsidies, some other country must complain about an actionable subsidy and be able to show injury before a country needs to change or eliminate the specific subsidy.<sup>215</sup> On the other hand, a non-actionable subsidy may not be taken to the WTO. A country that offers a specific subsidy needs to report or notify the WTO and provide some details about the size and operation of the programme. If the subsidy is not specific, it does not need to be notified.<sup>216</sup>

In the SCM Agreement, export subsidies are prohibited under Article 3.1(a) and subsidies contingent on the use of domestic goods over imported goods are prohibited under Article 3.1(b).<sup>217</sup> Article 27.2 provides for the special and differential treatment of developing country members for export subsidies, with a general exemption for some developing countries (Article 27.2(a)) and a phase-out period for

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<sup>213</sup> Engman et al. (2007) 45.

<sup>214</sup> Haywood and Ouya (2001).

<sup>215</sup> Ibid.

<sup>216</sup> Haywood and Ouya (2001).

<sup>217</sup> Engman et al. (2007) 45.

other developing countries (Article 27.2(b)).<sup>218</sup> Article 27.3 provides for a similar phase-out period for developing countries for subsidies contingent on the use of domestic goods over imported goods.<sup>219</sup>

#### **i. Prohibition of export subsidies**

According to Article 1 of the SCM Agreement, a subsidy is defined as a “financial contribution by a government or any public body which thereby confers a benefit”. Not only “direct transfer of funds (e.g. grants, loans and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees)” but also “government revenue that is otherwise due which is foregone or not collected (e.g. fiscal incentives such as tax credits)” are considered subsidies.<sup>220</sup> Article 3.1(a) of the SCM Agreement explicitly prohibits subsidies contingent on export performance and an illustrative list of export subsidies are included in Annex I attached to that Agreement. Thus, under this definition, various tariff exemptions, tax exemptions, provision of services other than general infrastructure at concessional rates would all fall under the definition of subsidies and would be prohibited if they are contingent on export.<sup>221</sup>

However, Footnote 1 to article 1.1(a)(1)(ii) of the SCM Agreement states that “the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amount not in excess of those which have accrued, shall not be deemed to be a subsidy”. Therefore duty free imports of raw material and intermediate inputs used in the production of goods for exports, and other duty drawback schemes of a similar nature, are exempted from the above definition of subsidies by virtue of this footnote.<sup>222</sup>

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<sup>218</sup> Ibid.

<sup>219</sup> FIAS (2008) 54.

<sup>220</sup> Engman et al. (2007) 45.

<sup>221</sup> Ibid.

<sup>222</sup> Ibid.

Similar treatment is provided for exemption or remission of indirect taxes on “inputs that are consumed in the production of the exported product” under certain conditions.<sup>223</sup> Certain allowance for wastage may also be allowed.<sup>224</sup> Duty free imports of capital goods used in the production of an exported product do not meet the requirements of the footnote<sup>225</sup> as they are not consumed in the production of the exported product, as provided under item (i) of Annexure I of the SCM Agreement.<sup>226</sup> For this reason many countries have trimmed down incentives to permitted exemptions or made such exemptions WTO consistent by relaxing the export requirement. Most SEZs allow final products to be imported upon payment of duties either on the final product or on the inputs used in production.<sup>227</sup>

**ii. Prohibition of subsidies contingent on the use of domestic goods over imported goods**

Article 3.1(b) of the SCM Agreement prohibits the use of “subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods”.<sup>228</sup> However, a phase-out period of eight years for least developed countries and five years for developing countries is provided for in terms of Article 27 of the SCM Agreement.

**5.9.3 Agreement on Trade-related Investment Measures**

The TRIMS Agreement provides an illustrative list of investment measures that are inconsistent with the provisions of Article III of the GATT (national treatment) and Article XI of the GATT (general

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<sup>223</sup> Item (g) and (h) of Annexure I of SCM Agreement, and Annexure II of SCM Agreement.

<sup>224</sup> Item (h) of Annexure I of SCM Agreement, and Annexure II of SCM Agreement.

<sup>225</sup> Footnote 61 in Annexure II states “Inputs consumed in the production process are inputs physically incorporated, energy, fuels and oils used in the production process and catalysts which are consumed in the course of their use to obtain the exported product”.

<sup>226</sup> Engman et al. (2007) 46.

<sup>227</sup> Ibid.

<sup>228</sup> Ibid.

elimination on quantitative restrictions).<sup>229</sup> Included in the list are trade-related investment measures which: (a) require “the purchase or use by an enterprise of products of domestic origin or from any domestic source” (commonly called local-content requirements); (b) require “that an enterprise purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports” (trade balancing requirements); or (c) “restricts the importation by an enterprise” by “restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise” (foreign exchange restrictions).<sup>230</sup>

A SEZ is a typical trade-related investment measure, although there is no specific mention of SEZs contained in the TRIMS Agreement. SEZs fit both the definition of “investment measures” and “trade related” as the key stated objectives of most SEZs are to attract more FDI and to promote exports.<sup>231</sup> Thus, any SEZ which has a local content requirement, a trade balancing requirement or a foreign exchange restriction would be in violation of the TRIMS Agreement without submission of a notification in accordance with Article 5.1 of the TRIMS Agreement.<sup>232</sup>

#### **5.9.4 Disputes**

For a dispute to be lodged a complaining member must demonstrate injury, nullification or serious prejudice beyond minimum amounts.<sup>233</sup> So, if you are maintaining a prohibited subsidy and somebody complains about it, the normal dispute settlement mechanism of the WTO is conducted at an accelerated pace.<sup>234</sup> Consequently, the results could be disastrous for a country that has based its development programme on such a subsidy.

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<sup>229</sup> Engman et al. (2007) 49.

<sup>230</sup> Ibid.

<sup>231</sup> Ibid.

<sup>232</sup> Ibid.

<sup>233</sup> Haywood and Ouya (2001).

<sup>234</sup> Ibid.

## **5.10 Technology Transfers and Information Exchange with Companies**

SEZs also improve industries focusing on enhanced technologies by providing research and development resources that allow countries to export more sophisticated manufactured goods.<sup>235</sup> Within these technologically sophisticated developments, large foreign firms often partner with smaller local firms, providing brand name recognition and large firm expertise that gives the local firm greater global marketing visibility.<sup>236</sup>

Therefore, the transfer of technology may be regarded as a huge potential benefit from foreign companies in the zone to domestic companies, particularly when countries such as South Africa suffer from a lack of education. The reason being that the people are too poor to send their children to school and that the government of the countries are too poor to subsidise education. One positive aspect of these strategies is that skills and knowledge will be transferred from the firms that locate there, which will not only benefit the rich but also the poor.<sup>237</sup>

## **5.11 Government Revenue**

The most frequently cited benefits of SEZs are increases in foreign exchange through FDI and exports.<sup>238</sup> It is argued that foreign exchange earnings linked with SEZs may ease some of the constraints that low income countries face, allowing them to source inputs and other import needs for the whole economy.<sup>239</sup> While there are some SEZs where domestic investors have been more dominant, such as Mauritius and

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<sup>235</sup> FIAS (2008) 36.

<sup>236</sup> Ibid.

<sup>237</sup> Brand (2002) 35.

<sup>238</sup> Engman et al. (2007) 25.

<sup>239</sup> Ibid.



India, the majority of SEZs focus on attracting FDI and have been very successful in some cases.<sup>240</sup>

### **5.12 Conclusion**

There are many implications to consider when implementing an SEZ programme. These implications cannot be ignored, and if a host country decides not to consider them, it could be disastrous. The previous South African IDZ programme was, to a large extent, a disappointment. Government would be wise to conduct a thorough cost-benefit analysis before implementation. Moreover, after implementation government should have the will, the lasting power and the capacity to persevere and to create SEZs we can be proud of.

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<sup>240</sup> Ibid.

## Chapter 6

### Conclusion and Recommendations

#### 6.1 Introduction

The fact that each country is unique, in terms of its unique trade units that capitalise on its own laws, customs, resources and trade practices, means that it is close to impossible to recommend the ideal legal and policy framework for the establishment of an effective and financially profitable SEZ. Some developments have been successful, and some fail. These successful and unsuccessful SEZs should serve as models for host countries seeking to develop new SEZs. As an economic development tool, SEZs can play a useful role in a country's economic development and act as a spearhead for reform if implemented correctly. It is therefore critical that the South African government, or any other government for that matter, before adopting the Draft Bill and Policy, be open to constructive criticism and recommendations.

#### 6.2 Comments to Consider

During February 2012, The DTI hosted several Provincial Public Participation Workshops. Based on these workshops, the following comments were formulated:

- The SEZ policy should be aligned with all existing policies. This would create a clear and decisive investment environment, which would prevent the possibility of the existence of double standards.
- As new policies are introduced, government should ensure that the SEZ policy, as well as all other policies related to it, be reviewed and updated. In layman's terms the SEZs policy should be checked against any changes to the industrial policy framework.

- Government should use examples of existing SEZs as a framework for implementation. However, South Africa should not just blindly follow the mainstream, and an African solution should be considered that would relate to Africa's unique developmental challenges.
- Private participation is essential for successful SEZ operation. Public-private partnerships will be an important factor in the success of SEZ implementation and operation.
- SEZs should be developed in regions where transport and communication infrastructure already exists or where there are existing plans to develop such infrastructure. This increases the likelihood of investor participation and success.
- Government should consider linking SEZ policy with existing regional integration programmes.
- SEZs should include a wide variety of sectors, including manufacturing, services, financial services and other areas of comparative advantage.
- SEZs should not be limited to state ownership.
- Clarity is needed on the existing DTI incentive scheme for various industry sectors and the proposed SEZ incentive in terms of how they will be implemented and their expected cost to the fiscus, as well as the subsequent potential increase in the tax burden on other businesses.

### **6.3 Summary of Findings**

SEZs alone will never be the answer to every economic problem. From the very first chapter, it was clearly indicated that SEZs should always just be one of many tools used by host countries to promote trade and economic development and attract investment. Chapter 2 set out the various types of zone and, taking into account the vast range of zones,

it is clear just how specialised these economic tools have become. Every major trading partner of South Africa benefits one way or another from these zones, whether they implement these zones themselves, or act as investors in foreign zones.

Chapter 3 brought the concept of SEZs home. It discussed the way in which South Africa implemented its first zone and how South Africa wishes to improve on this through the tabling of the new draft SEZ Bill and Policy.

Chapter 4, on the other hand, focused on the main reason for zone implementation, namely attracting FDI. As this chapter identified, there is a direct correlation between SEZs and FDI, and creating the ideal investment environment depends, to a large extent, on the way South Africa attracts investment, that is, primarily through the provision of incentives.

Chapter 5 examined certain implications that need to be taken into account before economic zones are implemented and certain advantages and disadvantages of zones were highlighted.

The final chapter, chapter 6, concludes the study with a proposed framework of best practices, formulated by the World Bank, which would set a benchmark for host countries to consider and would, finally, determine whether or not SEZs succeed or fail.

#### **6.4 Concluding Remarks**

In conclusion, not only do SEZs work; they are essential for a country to achieve its developmental goals. However, this paper has identified certain key factors without which SEZ implementation would be doomed to fail.

Firstly, location, location, location; the location would then automatically determine the type of SEZ to be used. Secondly, know thy trading partners. It is therefore important for a host country to

know who its competitors and/or potential investors are. Thirdly, a comprehensive investor friendly legal and policy framework should be drawn up. The draft SEZ Bill and SEZ policy intends to expand on the previous Manufacturing Development Act; however, the draft Bill is vague and not entirely informative leaving a great deal of room for improvement in both the policy and the legal framework. Fourthly, attracting FDI is essential for South Africa. Accordingly, zone implementation relies on the provision of proper incentives to attract investors to set up shop. However, as yet South Africa does not have a comprehensive incentive package. To accommodate potential investors, the Draft Bill should therefore list all incentives applicable to the relevant zones. Fifthly, a proper cost-benefit analysis should be conducted. Owing to the enormous expenses connected to SEZ development, host countries should be extremely careful that their expectations do not exceed their abilities. Lastly, SEZs have been around for approximately 60 years. Before implementation, host countries should take into account the “best practices” associated with SEZ development. Therefore, as a last concluding remark, this paper will conclude with a comprehensive list of best practices that should be considered when implementing an SEZ.

## **6.5 Special Economic Zones as Demonstrators of Best Practices**

The Foreign Investment Advisory Service examined the last 30 years of SEZ experience, reviewing development patterns and the economic impact of these zones worldwide.<sup>241</sup> Through these “lessons learnt” they have drawn up a list of best practices that will be beneficial to any SEZ developer.

### **6.5.1 Zone Concepts**

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<sup>241</sup> FIAS (2008) 51 - 57.

Best practice suggests that an SEZ model with the following features be adopted:<sup>242</sup>

- Permit industrial estates to host SEZ enterprises as well as those licensed under other regimes. The preferred approach is to allow all enterprises to co-locate within the same area, although the development of separately fenced-off areas solely for zone enterprises is an acceptable approach.
- Ensure that the SEZ regime is flexible, allowing a range of commercial as well as manufacturing activities. If properly supervised, a separate commercial zone regime is not required.
- Promote private rather than public development of zones. International experience suggests that this type of zone development increases the chances of success.

### **6.5.2 Core Policy Framework**

The key elements of a best practice policy framework include the following:<sup>243</sup>

- In terms of the concept of extra-territoriality, as defined in the Revised Kyoto Convention, SEZs should be treated as being outside the domestic customs territory, but should be eligible for national certificates of origin and to participate in trade and market access agreements.
- Private zones, benefits, obligations, rights and public–private partnerships for zone development are clearly defined. Where government-run zones exist, the legal framework should ensure that competition among private and public zones is on a level playing field and that public zones do not have unfair advantages (subsidies) that undercut private projects. The respective rights,

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<sup>242</sup> FIAS (2008) 51.

<sup>243</sup> Ibid. 52.

responsibilities and obligations of government and the private sector need to be defined to enable partnerships for zone development.

- Zone designation criteria – physical development standards and clear criteria for the designation of new zones are put in place. Generally, basic criteria include zone design and environmental standards, the financial and technical track record of the zone development group, and minimum equity requirements by the zone developer. The objective is to guide, but preserve, the flexibility of individual zone development proposals, while optimising the impact on government funding for off-site infrastructure connections.
- Eligibility criteria – the openness of an SEZ regime is defined in terms of minimum export requirements and the types of activity and ownership forms permitted. The best approach is to maximise the flexibility of the regime by removing minimum export obligations; broadening the range of eligible activities; removing any ownership restrictions; ensuring equal treatment of foreign and domestic investments; and insuring that indirect exporter benefits and privileges are given to firms in the domestic customs territory that supply goods and services to zone-based enterprises.
- Labour regime – international experience strongly suggests that the long-term competitiveness of a zone depends on the quality and productivity of its workers. To achieve this, it is important that labour regimes are fully consistent with ILO standards and obligations, including core rights of assembly, organisation and collective bargaining. At the same time, there should be the opportunity for freely negotiated labour productivity packages within zones and a generally flexible and liberal labour market regulatory framework. Additionally, the foreign worker

employment regime should be transparent, yet discourage excessive dependence on foreign workers at the expense of domestic ones.

### **6.5.3 Incentive Framework**

The following are guidelines for the design of an SEZ incentive framework:<sup>244</sup>

- Leverage the introduction or reform of zone regimes as an opportunity to rationalise income tax incentives. Ideally, this would result in the harmonisation of zone corporate income taxation policies, or at least make zone enterprise taxation comparable to that of promoted industries. The best practice approach for income tax incentives is to have performance-based incentives within a country's tax code rather than through special legislation such as SEZ regimes.
- Use zone regimes to advance de-monopolisation and deregulation of telecommunications and other utilities where applicable.
- Design an incentive framework that is WTO compliant. This is best done by removing any export obligations and allowing zone enterprises full access to the domestic market on a duty paid basis.

### **6.5.4 Regulatory Framework**

The following are key guidelines for the development of a best practice zone regulatory framework:<sup>245</sup>

- Put in place streamlined procedures for business registration that embody a simple declarative investment registration system rather than any sort of investment approval regime. Key elements include application to a single government office that provides

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<sup>244</sup> FIAS (2008) 54.

<sup>245</sup> Ibid. 56.



the licence; promulgation of a negative list of ineligible activities and other explicit criteria for approval or denial; and a default clause authorising automatic approval of the application if no ruling has been issued within the review period.

- Facilitate provision of secondary permits and authorisations. Additional permits, land, buildings, labour, health and safety, and so on, can be facilitated by vesting all such authorisation with the zone authority rather than with other ministries or agencies. The zone authority should have offices within each zone to perform these services.
- Develop special customs rules and regulations drawing on WCO and WTO provisions, and fast track implementation of automated customs systems, with proper inventory controls and audit systems, within the SEZs.

#### **5.4.5 Institutional Framework**

Good practice guidelines for the development of an effective institutional framework ensure the following:<sup>246</sup>

- Sufficient autonomy of the zone authority, particularly over staffing, budgets, spending and policymaking.
- Adequate authority by constituting an independent board comprised of key government ministers and private sector representatives reporting to the highest level of government. Ideally, allow private sector representatives to constitute the majority of board membership to ensure flexibility, results orientation and customer focus.
- A one-stop-shop approach through legislation that provides the body with single point authority over other government agencies in core areas.

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<sup>246</sup> Ibid.

- The zone entity delegates, outsources and privatises as many non-core functions and services as possible to focus on core activities.

#### **5.4.6 Physical Development and Management**

The following are best practice guidelines for the physical development of zones:<sup>247</sup>

- Implement land use planning and zoning efforts in defined areas for industrial and commercial development to guide the actions of private developers.
- Develop zone designation criteria in the zone law and implementing regulations to ensure that private zones are conveniently located and minimise off-site infrastructure development expenditures of government.
- Establish a land use planning and infrastructure development unit in the government to ensure adequate support of off-site infrastructure provision.

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<sup>247</sup> Ibid. 57.

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