

**TITLE:** **ESTABLISHING SPECIAL ECONOMIC  
ZONES IN THE DEMOCRATIC  
REPUBLIC OF CONGO: IN SEARCH OF A  
SOUND LEGAL FRAMEWORK**

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Dissertation Submitted In Partial Fulfilment of the Requirements For The  
Degree of Master of Laws (LL.M) In International Trade, Investment and Business Law

## DECLARATION

I declare that this Mini-Dissertation which is hereby submitted for the award of Legum Magister (LL.M) in International Trade, Investment and Business Law in Africa at International Development Law Unit, Centre for Human Rights, 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.

Signed

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## ABSTRACT

The DRC has recently embarked on a new SEZ project. The country does not have a history of success with SEZs, however, much like other African countries. This paper investigates the past and current legal frameworks governing SEZs in the DRC, in an attempt to identify their weaknesses and strengths, with the ultimate goal of finding room for improvement and preventing the failures from the past from occurring again. Because the DRC cooperates closely with South Africa on SEZ regulation, the paper also delves into the South African experience, to see whether the DRC can already draw lessons from South Africa. The study then formulates a number of recommendations including that a new fiscal and non-fiscal incentive framework should be established.

## LIST OF ABBREVIATIONS

ANAPI	DRC National Agency for Investment Promotion
CAZES	DRC Agency for Special Economic Zones
CCA	Customs Control Area
CIF	Cost, Insurance and Freight
CIP	Critical Infrastructure Programme
COMESA	Common Market for Eastern and Southern Africa
CSA	Customs Secured Areas
DRC	Democratic Republic of Congo
DTI	Department of Trade and Industry
EPZ	Export Processing Zone
GATT	General Agreement of Trade and Tariffs
LDC	Least Developed Country
FDI	Foreign Direct Investment
FIAS	Facility of Investment Climate Advisory Services
FTZ	Free Trade Zone
IDZ	Industrial Development Zone
IFC	International Finance Corporation
ILO	International Labour Organisation
OECD	Organisation for Economic Corporation and Development
PPP	Public Private Partnership
SADC	Southern African Development Community
SCM	Agreement on Subsidies and Countervailing Measures
SEZ	Special Economic Zone
TRIMS	Agreement on Trade Related Investment Measures
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added tax
WGPP	Western Growth Poles Project
WTO	World Trade Organisation
WCO	World Customs Organisation
ZOFI	<i>Zone Franche d'Inga</i>

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## CHAPTER 1

### INTRODUCTION

#### 1.1 Background to the study

The attraction of foreign direct investment (FDI) into Africa is a prominent feature of the trade and investment policies of most African countries and regional trade groups such as the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA). FDI may be defined as “investments by a multinational company in establishing production, distribution or marketing facilities abroad”.<sup>1</sup> FDI occurs when an enterprise resident in one economy (direct investor), obtains a lasting interest in an enterprise resident in another economy (direct investment enterprise), implying a long term relationship.<sup>2</sup> The SADC Protocol on Finance and Investment (SADC Protocol) requires member states to promote entrepreneurship in industries that specifically attract FDI.<sup>3</sup> Likewise, the COMESA Treaty recognises the need for effective resource mobilisation and investment.<sup>4</sup> It acknowledges the importance of increasing flows of private sector investment into the common market and provides for measures to attract all forms of investment, including FDI.<sup>5</sup>

Africa has successfully implemented a number of initiatives and policies to attract FDI at both national and regional levels. The continent’s global share of FDI has accordingly grown from 3.2% in 2007 to 5.6% in 2012.<sup>6</sup> This is opposed to the 1990s, where Africa attracted less than 2% of global FDI flows.<sup>7</sup> The commitment to attract FDI can be explained by the change in

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<sup>1</sup> C Pass, B Lowes & L Davies. *Collins Internet-Linked Dictionary of Economics* 4th edition, HarperCollins Publishers, Glasgow (2005).

<sup>2</sup> M Neuhaus *The Impact of FDI on Economic Growth: An Analysis for the Transition countries of Central and Easter Europe* (2006) 42.

<sup>3</sup> Article 3 of Annex 1.

<sup>4</sup> Article 158.

<sup>5</sup> Article 158 & 159.

<sup>6</sup> Ernst Young ‘Africa’s share of global FDI increases over the last five years’

[http://www.ey.com/GL/en/Newsroom/News-releases/News\\_Africa-share-of-global-FDI-increases-over-the-last-five-years](http://www.ey.com/GL/en/Newsroom/News-releases/News_Africa-share-of-global-FDI-increases-over-the-last-five-years) (accessed on 27 May 2014).

<sup>7</sup> WA Naude & WF Kruge ‘Investigating Geography And Institutions As Determinants Of Foreign Direct Investment In Africa Using Panel Data’ *Journal of Applied Economics* (2007) 39 1223  
<http://www.tandfonline.com/doi/pdf/10.1080/00036840600567686>



attitude from the former import substitution and “beggar thy neighbour” policies of post-colonial Africa, to pro-FDI policies.

Legal rules and policies of a host country play a central role to the quality and quantity of FDI flows it attracts. Such rules can create locational advantages that attract investors to one country instead of another. Thus, legal rules that effectively improve the business environment and reduce risks, are classified among the key determinants of FDI flow into Africa.<sup>8</sup> The Preamble to Annex 1 of the SADC Protocol recognises that without effective investment policies, protection and promotion, a region will experience marginalised to be marginalised investment inflows and sustainable economic development. Special Economic Zones (SEZs) are among the investment policy being adopted by countries to attract FDI, boost employment, increase exports and generate foreign exchange.<sup>9</sup> The focus on the creation of SEZs and similar investment attraction policies has come at a time when the world is looking to Africa as an investment destination. While SEZs are not entirely novel to Africa, their establishment gained momentum over the past decade.

The DRC, like other African countries, has aligned its economic policy towards the attraction of investment, especially in key sectors in which the country has a comparative advantage. As part of its policy, the country has embarked on an SEZ Programme with support from the IFC and the World Bank. This is in line with its mandates under the SADC Protocol which requires the DRC to collaboratively develop a framework for tax incentives that will draw FDI into the region.<sup>10</sup> SEZs may also help the country emerge from the effects of many years of conflict which have effectively deterred incoming foreign investment capital.<sup>11</sup> The SEZ Programme entails the creation of five SEZs from 2012 to 2015, with the pilot SEZ having been created in

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<sup>8</sup> WA Naude & WF Krugle (n 7 above) 1224.

<sup>9</sup> ILO Committee on Employment and Social Policy ‘Third Item on Agenda’ (2003) 2  
[http://www.ilo.org/public/libdoc/ilo/GB/286/GB.286\\_esp\\_3\\_engl.pdf](http://www.ilo.org/public/libdoc/ilo/GB/286/GB.286_esp_3_engl.pdf)

<sup>10</sup> Article 4 of Annex 3.

<sup>11</sup> E Ouayoro ‘Congo moves on from lost years’ (2013)

<http://www.worldbank.org/en/news/opinion/2013/02/10/congo-moves-on-from-lost-years> (accessed on 18 November 2013).

*Maluku*; and others to be created in (i) in *Katanga*, (ii) from *Kasai* to *Ilebo*, (ii) on the *Kisangani* to *Mbandaka* axis, and (iv) in *Beni-Butembo*.<sup>12</sup>

The attraction of FDI into a least developed country (LDC) like the DRC is not a simple task despite the World Bank's observation that "the DRC has the potential to be one of the richest countries on the African continent and a driver for African growth".<sup>13</sup> The country is in a fragile state and in need of post-conflict reconstruction.<sup>14</sup> The challenges, threats and hindrances the country faces are not unique; they are shared by numerous resource-endowed African countries and have been described as the "resource curse phenomenon".<sup>15</sup> Hence, despite potential investment returns, both local and foreign investors face challenges under the current legal, regulatory and infrastructural frameworks of the country. The World Bank's Doing Business 2014 Report indicates that the ease of doing business in the DRC remains a barrier for investment.<sup>16</sup> The country currently ranks 183<sup>th</sup> out of 189 countries in eleven key areas assessed in the Report, namely starting a business, obtaining construction permits, accessing electricity, registering property, obtaining credit, investor protection, tax payment, cross-border trading, contract enforcement, insolvency matters and employing workers.<sup>17</sup> Consequently, the rationale behind the use of SEZs in the DRC is based on the premise that regulatory, institutional and spatial-infrastructure constraints have made the prevailing business environment uncondusive for easy and cost-effective investment to occur.<sup>18</sup> SEZs have the

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<sup>12</sup> 'RDC : la création des zones économiques spéciales en discussion à l'Assemblée nationale' <http://radiookapi.net/economie/2013/11/05/rdc-la-creation-des-zones-economiques-speciales-en-discussion-lassemblee-nationale/> (accessed on 22 November 2013).

<sup>13</sup> World Bank 'World Bank Democratic Republic of Congo Overview' <http://www.worldbank.org/en/country/drc/overview> (accessed on 13 January 2014).

<sup>14</sup> World Bank 'Democratic Republic of Congo overview' <http://www.worldbank.org/en/country/drc/overview> (accessed on 18 November 2013).

<sup>15</sup> VN Fru *International law on foreign investment and host economies in Sub-Saharan Africa* (2012) 81.

<sup>16</sup> World Bank 'Ease of doing business in Congo, Dem. Rep' (2013) 4 <http://www.doingbusiness.org/data/exploreeconomies/congo-dem-rep/~media/giawb/doing%20business/documents/profiles/country/ZAR.pdf?ver=2> (accessed on 16 November 2013).

<sup>17</sup> World Bank (n 16 above).

<sup>18</sup> C Baissac 'Special economic zones for South Africa: Lessons from experience' <http://www.agbiz.co.za/LinkClick.aspx?fileticket=sNrsFU61htM%3D&tabid=357> (accessed on 22 November 2013)

potential to alleviate the challenges that investors currently face while doing business in the DRC.<sup>19</sup>

It is yet to be seen whether there is a business case for the establishment of SEZs in the DRC. There is however a legal case for their establishment and for the formulation of an adequate legal framework. The mere creation of an SEZ does not automatically guarantee the attraction of FDI; as a starting point, there have to be effective and well-implemented legal and regulatory policies. When well-crafted and implemented, SEZs can be a promising strategy for industrialization, infrastructure development, services and employment in African LDCs. The true test for the DRC is whether and to what extent it will harness its potential through the use of SEZs.

## 1.2 Problem statement

The extent to which SEZs will be successful and beneficial to the DRC primarily hinges on the establishment of an adequate legislative framework that is in line with international best practice

In the 1970s, the country (then called Zaire) established the ZTZ; *Zone Franche d'Inga* (ZOFI), which failed to achieve its objectives due to poor conceptualization and implementation.<sup>20</sup> Despite this failed experience, the DRC has begun to re-establish SEZs as part of its investment and industrial development policy. In 2010, the International Finance Corporation (IFC) conducted an assessment of the DRC's SEZ framework. In a progress report of May 2010, the IFC proposed a new draft SEZ law which purportedly incorporated international best practice and local practice.<sup>21</sup> The IFC did however not publish their analysis of existing laws that affect

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<sup>19</sup> T Farole & J Kweka 'Institutional Best Practices for Special Economic Zones: An Application to Tanzania World Bank' (2001) 1 [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2011/09/15/000386194\\_20110915033606/Rendered/PDF/644830BRI0Tanz00Box0361538B0PUBLIC0.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2011/09/15/000386194_20110915033606/Rendered/PDF/644830BRI0Tanz00Box0361538B0PUBLIC0.pdf)

<sup>20</sup> D Madani 'A Review of the Role and Impact of Export Processing Zones' <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-2238> (Accessed on 3 December 2013).

<sup>21</sup> IFC 'Democratic Republic of Congo Special Economic Zone Program Progress Report: July - December 2010' (2010) 4 <https://www.wbginvestmentclimate.org/publications/upload/DRC-SEZ-Report-July-December-2010-for-Internet.pdf> (Accessed on 3 December 2013).

SEZs, how local and international best practice were incorporated in the new draft, and to what extent each contributed to their analysis. This report raises questions which require answering, especially as the DRC has begun to implement SEZs after previously grappling with crafting and implementing them. If the current SEZ Program fails, it will have a negative impact on the economy due to the large amounts of capital injected into its establishment and management.<sup>22</sup> For the new SEZ regime to avoid suffering a similar fate as the *Zone Franche d'Inga*, the gaps and inefficiencies in the legislative framework need to be identified and addressed. The forgoing has thus necessitated this study.

### 1.3 Thesis statement

This study argues that if SEZs in DRC are properly implemented, they will not only potentially attract FDI and create a more conducive business environment, but will assist the country to tackle some of the war-related challenges that it faces. The extent to which SEZs will be beneficial to the DRC, as well as meet her development priorities and objectives primarily hinges on the establishment of an adequate legislative framework that is in line with international best practice.

### 1.4 Research questions

The main research question of this study is: what are the legal rules that should be developed for an SEZ to become an effective policy tool for the attraction of FDI both in quantity and quality?

In particular, the study seeks to answer the following questions:

- i) What is the nature of SEZs in theory and practice?
- ii) What is the existing legislative framework for SEZs in the DRC and is it in line with international best practices?

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<sup>22</sup> The International Development Association has advanced credit amounting to a total project cost of US\$ 114.70million for the SEZ Program. World Bank 'Dem Rep Congo - Western Growth Poles' <http://www.worldbank.org/projects/P124720/dem-rep-congo-western-growth-poles?lang=en> (Accessed on 13 January 2014).

- iii) What has been the South African experience with SEZs and what lessons can the DRC learn from the South Africa?

## 1.5 Objectives and significance of research

The broad objective which is sought to be achieved by this research is to examine and provide sound recommendations on the legal and policy options and strategy for the establishment of an effective legislative framework for SEZs in the DRC. Additionally, the study will also draw lessons from South Africa. Although DRC and South Africa have different histories and their development has taken somewhat different trajectories, South Africa has been selected as a case study because both are African countries and there exists similarities between some of the challenges they have faced with SEZs. Furthermore, there is co-operation between the two countries with regard to their SEZ programmes.

The research is particularly significant because it will contribute to the growing debate on whether SEZs are the right policy tools for the attraction of investment in the DRC and the right legislative framework which should be established. The subject is timely because there is presently very limited literature on SEZs in the DRC context, although some scholars have written generally on investment in the country. This study will thus enable DRC to fully utilise SEZs, by informing policy formulation, while drawing lessons from another African country.

## 1.6 Literature review

Despite the fact that SEZs are not new to Africa, few studies exist that address their nature and purpose from an African context.<sup>23</sup> From the available literature, it is evident that among the more contentious issues relating to SEZs is the primary question of whether SEZs are the right tool for economic development, especially in LDCs. This debate emanates from the fact that the African SEZ experience has been rather unsuccessful despite the proliferated establishment of SEZs.<sup>24</sup> Sean Woolfe correctly points out that despite their potential, the use of SEZs as an

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<sup>23</sup> T Farole *SEZs in Africa: Comparing Performance and Learning from Global Experience* (2012) 13

[file:///C:/Users/User/Downloads/12126\[1\].pdf](file:///C:/Users/User/Downloads/12126[1].pdf)

<sup>24</sup> T Farole & J Kweka (n 19 above).

instrument of economic development has been much debated in the literature over the past decades.<sup>25</sup> Woolfey points out that two views have emerged internationally regarding the use of SEZs.<sup>26</sup>

The first view in the debate comes from proponents of SEZs, who believe that SEZs can provide “a gradual ‘alternative to neo-liberal’ ‘shock therapy’ and an economic policy reform for acting as demonstration areas”.<sup>27</sup> As a proponent of SEZs, Thomas Farole argues that despite previous poor performances of African SEZs, they still play a significant role in many African countries, which are firstly in need of diversification and FDI, and secondly are in the early stages of development or deindustrialisation.<sup>28</sup> Farole’s studies of SEZs reveal that as a concept, SEZs are not bad, however African countries have failed to fully utilise them due to implementation challenges.<sup>29</sup>

The second view comes from opponents of SEZs, who consider them as measures that delay wider legal and policy reforms by creating enclaves “that allow for the continued protection of inefficient domestic industries”.<sup>30</sup> The on-going debate against SEZs rests on the notion that it is a second best policy to nation-wide liberalisation.<sup>31</sup> Woolfey points out that SEZs have also been criticized “for hosting import-dependent activities that do not add significant value: perpetuating low-skill assembly operations, attracting FDI in low-skill, low-technology and foot-loose industries; supporting labour rights; allowing poor workplace health and safety conditions; and having weak environmental controls.”<sup>32</sup>

In the light of the above literature review, it is evident that the question of SEZs and the extent of their value to countries that are implementing them is a complex question. It is difficult to

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<sup>25</sup> S Woolfey, Chapter 7, *Special Economic Zones and Regional Integration in Africa*, Tralac, 111. Chapter in book Cape to Cairo: Exploring the Tripartite FTA Agenda <http://www.tralac.org/images/docs/5548/cape-to-cairo-4complete.pdf>

<sup>26</sup> S Woolfey (n 25 above) 112.

<sup>27</sup> S Woolfey (n 25 above) 111 – 112.

<sup>28</sup> T Farole (n 24 above) 14.

<sup>29</sup> Farole in his study he provides for international best practice principles which if well implemented could lead to more favourable results. T Farole (n 24 above) 14.

<sup>30</sup> S Woolfey (n 25 above) 112.

<sup>31</sup> T Farole (n 23 above) 18.

<sup>32</sup> S Woolfey (n 25 above) 112.

determine whether trade policies should be preferred over SEZs, as different countries adopt SEZs for various reasons, although a common thread may be the attraction of FDI. The performance of SEZs in Africa has been affected by the construction of the underlying policy, implementation as well as geographical specific factors. As such, different countries have had different experiences, with Mauritius having created successful SEZs, Kenya, Madagascar and Lesotho having an average outcome, and the rest of the countries still grappling at different levels.<sup>33</sup> As such, the author agrees with the view that SEZs should be viewed from a context dependent perspective and countries should implement a clear framework that takes into account international best practice while making adaptations to local idiosyncrasies.<sup>34</sup>

## **1.7 Research methodology**

The approach adopted in this research will be descriptive, analytical and prescriptive. The descriptive approach will be used in providing an overview of the concept of SEZs, while the analytical approach will be used in evaluating the DRC's current and proposed legislative regime and the prescriptive approach will be used to form recommendations.

The research will entail a qualitative review of literature, including primary sources, such as policies and legislation from the DRC, and secondary sources, including reports by non-governmental organisations, conference proceedings, working papers, journal articles and books. These sources have been obtained primarily by desktop, library and on-line database search.

## **1.8 Scope and limitations**

This study will focus on SEZs in the DRC and the comparative study on the South African model only goes so far as it provides best practices or failures which may be of interest to the DRC's SEZs. This study does not extensively delve into the economic argument of the extent

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<sup>33</sup> T Farole (n 23 above) 1.

<sup>34</sup> T Farole (n 23 above) 14.

to which SEZs contribute to FDI, the question of economic performance of SEZs and the theoretical relationship between FDI and SEZs.

The limitation to this study is the dearth of relevant literature on SEZs in the DRC. Added to this is the fact that most of the available resources are in French and require translation.

## **1.9 Outline of chapters**

This chapter sets the stage by covering introductory matters which include: the background, problem statement, thesis statement, research questions, objectives and significance, research methodology, scope and limitations. Chapter two examines the meaning of the term “SEZ”, its nature and the key features of SEZs. The third chapter then investigates the current legal framework governing SEZs in the DRC and the potential challenges that the country may face under this current legal framework. The chapter will also delve into the proposed new SEZ regime which the country wishes to establish and whether it adequately addresses challenges under the current regime. The fourth chapter makes a comparative analysis of the South African SEZ regime and aims to draw lessons from it. Lastly, the fifth chapter provides a summary of the findings in the study, draws conclusions and makes recommendations.



## CHAPTER 2

### SEZs AND THE LEGAL MODELING

#### 2.1 Introduction

This chapter examines the theoretical basis and the categorisations of SEZs. Before considering the legal frameworks that have governed past SEZs and govern contemporary SEZs, it is first necessary to refine the definition of SEZs in order to understand their nature both in theory and in practice. This chapter will not only do so, but will go a step further and examine the concept of international best practice with respect to key features of SEZ frameworks, and explore the interface between SEZs as a national tool and different spheres of international law.

#### 2.2 Defining the term “SEZ”

SEZs are “geographically delimited areas administered by a single body, offering certain incentives (generally duty-free importing and streamlined customs procedures, for instance) to businesses which physically locate within the zone”.<sup>35</sup> However there is neither a standardisation of terminologies, nor is there a standard model for SEZs. With regard to terminology, different countries use different terms to denote various investment incentive schemes, which may be classified under the umbrella term “SEZ”. By way of illustration, the wide spectrum of terminologies has ranged from “public free zones” in Egypt, “*maquiladoras*” in Mexico and “exclusive economic zones” in the Maldives.<sup>36</sup> The terminologies used to denote the different spectrum of SEZs is sometimes used interchangeably.<sup>37</sup> Irrespective of the differences in nomenclature, zones possess some common features with respect to their objectives. Therefore this study utilises the term “SEZ” as the generic term encompassing the broad range of “spatially defined areas that combine infrastructure and policy instruments with

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<sup>35</sup> FIAS ‘Special economic Zones performance, lessons learned, and implications for Zone development’ (2008) 2 <https://www.wbginvestmentclimate.org/uploads/SEZs%20-%20Performance,%20Lessons%20Learned%20and%20Implications%20for%20Zone%20Development.pdf> (accessed on 18 November 2013).

<sup>36</sup> A Palit & S Bhattacharjee *Special Economic Zones in India: Myths and Realities* (2008) 6 & 7.

<sup>37</sup> A Palit & S Bhattacharjee (n 36 above) at 7.

the aim of promoting investment and exports”.<sup>38</sup> Lacking a standard model for SEZs, many countries have developed *ad hoc* models based on their specific trade and investment objectives. The FIAS 2008 Report on SEZs provides a non-exhaustive list of types of SEZs:

- **Enterprise zones** are aimed at revitalising distressed urban and rural areas by granting tax incentives and financial grants,<sup>39</sup> and by increasing private sector participation.<sup>40</sup> They exclude duty free imports but may provide zoning relief, tax payment and licence exceptions.<sup>41</sup> The main activities conducted in enterprise zones include manufacturing, trade and other related commercial activities.<sup>42</sup>
- **Export processing zones (EPZs)** are “industrial zones with special incentives set up to attract foreign investors, in which imported materials undergo some degree of processing before being (re)exported again”.<sup>43</sup> EPZs generally take the form of industrial estates, but can also be hybrids which are classified as (i) general zones open to all industries, and (ii) separate zone areas reserved for export-oriented enterprises.<sup>44</sup> They are primarily geared towards producing exports for foreign markets.<sup>45</sup> They are currently the most contentious form of SEZ as they are predominantly labour intensive and non-compliance with ILO standards may be an issue.
- **Free ports** facilitate imports and exports, as such, they may encompass much larger areas, such as international airports, sections of cities, islands and whole countries.<sup>46</sup> They provide different kinds of activities such as tourism and retail sales, and may permit on-site residence. Free ports typically provide a broader set of incentives and benefits including customs duty exceptions, relaxed labour laws and deregulated utilities.<sup>47</sup>

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<sup>38</sup> T Farole (n 23 above) 16.

<sup>39</sup> FIAS (n 35 above) 3.

<sup>40</sup> A Palit & S Bhattacharjee (n 36 above) 5.

<sup>41</sup> A Palit & S Bhattacharjee (n 36 above).

<sup>42</sup> A Palit & S Bhattacharjee (n 36 above).

<sup>43</sup> ILO ‘*Export Processing Zones (EPZs)*’ (2009)

[http://www.ilo.org/actrav/areas/WCMS\\_DOC\\_ATR\\_ARE\\_EPZ\\_EN/lang--en/index.htm](http://www.ilo.org/actrav/areas/WCMS_DOC_ATR_ARE_EPZ_EN/lang--en/index.htm)

<sup>44</sup> Facility of Investment Climate Advisory Services *Special economic Zones performance, lessons learned, and implications for Zone development* 2008 3 <https://www.wbginvestmentclimate.org/uploads/SEZs%20-%20Performance,%20Lessons%20Learned%20and%20Implications%20for%20Zone%20Development.pdf>

<sup>45</sup> FIAS (n 35 above).

<sup>46</sup> FIAS (n 35 above).

<sup>47</sup> FIAS (n 35 above).

- **Free trade zones (FTZs)**, or commercial free zones, are fenced-in, duty-free areas, which offer a variety of services such as warehousing, trade distribution facilities, transshipment, and re-export operations.<sup>48</sup>
- **Single factory zones**, unlike other types of SEZs, provide incentives and privileges to single enterprises.<sup>49</sup> They do not require separate physical enclaves.<sup>50</sup> Due to their nature, enterprises can benefit from incentives irrespective of their location.<sup>51</sup>
- **Specialized zones** are zones which are more geared towards the science and technology industry. They mostly include airport-based zones, logistics parks, petrochemical zones and science and technology parks.<sup>52</sup>

### 2.3 Key features of SEZs

On a very rudimentary level, an examination of the key features of SEZs can be broken down into three broad characteristics; (i) special, (ii) economic and (iii) zone.

SEZs create a “**special**” regime for investors, separate from the investment regime of the host country. It is not clear from literature how “special” a zone must be to be considered an SEZ.<sup>53</sup> There must however be some sort of uniqueness in the zone’s legal, administrative, regulatory or infrastructural system. SEZs thus generally have different corporate, customs, labour and tax laws that require a dedicated governance body.<sup>54</sup> They also provide higher quality roads, water and energy supplies, and telecommunications infrastructure, than what is typically found elsewhere in a host country. Administratively, they may offer easier procedures and lower costs, ranging from customs clearance to business entry and operating costs, in order to make investments more competitive and to encourage firms to locate within the zone.

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<sup>48</sup> FIAS (n 35 above).

<sup>49</sup> FIAS (n 35 above).

<sup>50</sup> T Farole (n 23 above) 26.

<sup>51</sup> FIAS (n 35 above).

<sup>52</sup> FIAS (n 35 above).

<sup>53</sup> OECD ‘Towards Best Practice Guidelines for the Development of Economic Zones’ (23 November 2009) 5

<http://www.oecd.org/mena/investment/44866585.pdf>

<sup>54</sup> T Farole (n 23 above) 24.

The term “**economic**” broadly refers to the activities carried out in the zone. The primary activities differ depending on the objectives of the model; zones may for instance focus on the export industry, manufacturing industry or technology. Naturally, these activities will have a bearing on the kind of infrastructure contained in the zone.

“**Zone**” first and foremost relates to the geographical spaces—delimited parts of a national territory—and secondly to the legal spaces that provide the unique regime. In the past, this largely denoted geographical enclaves where zones were located. Although this trend may still be common, some contemporary SEZs have completely done away with geographical demarcations and only refer to “purely legal spaces”.<sup>55</sup>

## 2.4 International best practice

SEZs can be a beneficial economic tool but they easily fail when the underlying policies are not designed and implemented effectively. There is no golden formula that guarantees success, as they are to a greater extent geo-specific and model-specific, however policy choices and the strength of the legal, regulatory and institutional framework play a leading role.<sup>56</sup> The formulation of legal policies is not a simple task as SEZs are complex policy instruments.<sup>57</sup> The complexity arises because, on the one hand SEZs entail the formulation of a unique system that works within the national context and on the other hand, it also requires careful consideration and balancing between the national objectives of a state and its international and regional obligations.

There are currently no universally accepted ‘best practice guidelines’ for the development of SEZs, however, institutions including the Organisation for Economic Co-operation and Development (OECD), World Bank, ILO and World Customs Organisation (WCO) have conducted research and developed principles that inform what is considered “best practice”. The OECD best practice guiding principles provide the most comprehensive guidance on

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<sup>55</sup> S Woolfey (n 25 above) 109.

<sup>56</sup> Government of Rwanda ‘Special Economic Zone Policy’ (2010) 11

[http://www.minicom.gov.rw/IMG/pdf/SEZ\\_Policy\\_Cleaned\\_.pdf](http://www.minicom.gov.rw/IMG/pdf/SEZ_Policy_Cleaned_.pdf)

<sup>57</sup> T Farole (n 23 above) XIV.

international best practice on SEZ legal policy formulation.<sup>58</sup> They deal with six elements: (i) the model of the zone to be established; (ii) the policy framework; (iii) the incentive framework; (iv) the regulatory framework; (v) the institutional framework; and lastly, (vi) physical development and management of zones.<sup>59</sup> For the purpose of this study, the focus will be directed on the incentive, regulatory and institutional frameworks which together form part of the legal structure of SEZs.

#### 2.4.1 Incentives framework

The granting of financial incentives to foreign investors is a common practice in many countries, but is a contentious subject in the debate on attracting FDI.<sup>60</sup> Sornarajah points out that nothing in international law prevents the granting of such incentives, however he questions their usefulness in attracting foreign investment.<sup>61</sup> This is a question that requires empirical research and has not as yet been resolved in literature. The granting of fiscal incentives also raises issues regarding discrimination between foreign and other investors and the potential violations of national treatment and most-favoured-nation treatment.<sup>62</sup> Sornarajah postulates that there can be no objection to discrimination based entirely on economic factors.<sup>63</sup> Further, the legality of discrimination can be justified by providing an adequate basis for the differential treatment, “such as the need to attract certain types of technology or to direct the foreign investor into certain channels of production”.<sup>64</sup> Fiscal incentives although controversial can be positively utilised by countries to indirectly achieve objectives, which otherwise may be too burdensome to foreign investors.<sup>65</sup> Instances where this is relevant include where tax incentives may be granted for purchasing new equipment; thus leading to the modernisation of manufacturing plants.<sup>66</sup>

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<sup>58</sup> As has been previously indicated, there is a variety of technology, so while this study uses the term SEZ as an umbrella term, the OECD uses “economic zone” in the same manner, however the terms are interchangeable.

<sup>59</sup> OECD (n 54 above) 10.

<sup>60</sup> M Sornarajah *The International Law of Foreign Investment* (2004) 115.

<sup>61</sup> M Sornarajah (n 60 above).

<sup>62</sup> M Sornarajah (n 60 above) 116.

<sup>63</sup> M Sornarajah (n 61 above).

<sup>64</sup> M Sornarajah (n 61 above).

<sup>65</sup> M Sornarajah (n 60 above) 115- 116.

<sup>66</sup> M Sornarajah (n 61 above).

There is a move away from the over reliance on tax incentives in SEZs. Where they are used, they should be formulated and implemented in a manner that does not lead to loss of revenue for countries. To prevent this, they should be linked to the actual process of capital formation.<sup>67</sup> In this regard, sweeping measures such as tax holidays often encourage tax planning rather than productive investment while investment tax credits and duty exemptions on capital goods have the effect of capital formation.<sup>68</sup> Fiscal incentives require monitoring and periodic evaluation to ensure they are meeting their intended policy objectives.<sup>69</sup> The policy objective should be designed to encourage zones to compete on the basis of facilities and services rather than only on the basis of fiscal incentives.<sup>70</sup> This is especially crucial in countries with multiple zones that may become susceptible to intra-zone competition.<sup>71</sup> To prevent this; the OECD encourages that a common set of incentives and privileges for all zone types in a country be formulated in order to reduce the problem of competing zone regimes.<sup>72</sup> Further, performance-based incentives should be included within a country's tax laws rather than through special legislation, to prevent having too many tax regimes which may strain resources and the effectiveness of national tax administration.<sup>73</sup>

#### **2.4.2 Regulatory framework: simplification and streamlining of procedures**

SEZs require efficiency in their regulatory frameworks. In particular, procedures such as investment approvals, granting of import and export licenses, foreign exchange access and accelerated on-site customs inspection procedures are sometimes overlooked in the policy formulation.<sup>74</sup> The facilitation of authorisations and streamlining of procedures can be achieved through the creation of a “one-stop shop” zone authority akin to a “single window” in trade facilitation, and simplified investment registration systems.<sup>75</sup> For instance, applications should be submitted to a single government office that provides the license, publicises all criteria for

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<sup>67</sup> OECD (n 53 above) 1.

<sup>68</sup> OECD (n 53 above) 13.

<sup>69</sup> OECD (n 53 above) 13.

<sup>70</sup> OECD (n 53 above) 12.

<sup>71</sup> OECD (n 53 above) 13.

<sup>72</sup> OECD (n 53 above) 13.

<sup>73</sup> OECD (n 53 above) 13.

<sup>74</sup> OECD (n 53 above) 14.

<sup>75</sup> OECD (n 53 above) 14.

approval or denial, reviews decisions, authorises automatic approvals of application absent rulings within the review period.<sup>76</sup>

### 2.4.3 Institutional framework: private sector involvement

A major determination for the success of an SEZ is the impartiality of the zone authority and the limitation of its activities to purely regulatory functions and preferably move away from owning, developing or operating zones.<sup>77</sup> This would eliminate any conflict of interest arising from the regulating body having the authority to approve zones and projects and at the same time owning specific zones.<sup>78</sup> The growing trends with modern SEZs is to have public private partnerships (PPP). The OECD suggests that any non-core functions and services should be outsourced and privatized as much as possible.<sup>79</sup> The PPP arrangement should clearly set out the rights, responsibilities, obligations and commitments the parties. The PPP frameworks may take the following forms:

- i) Public provision of off-site infrastructure and facilities such as connections and roads, while private funding caters for on-site infrastructure and facilities;
- ii) Build Transfer and Operate and Build Operate Own approaches to on-site and off-site infrastructure and facilities with government guarantees and financial support;
- iii) Contracting private management for government owned zones or of government zone assets (beneficial ownership);
- iv) Equity shifting arrangements which provide private contract managers of government zones a purchase option on achieving pre-defined performance levels have been reached.<sup>80</sup>

Whichever model of PPP is chosen, the zone authority should be responsible for all approvals and licenses and assist private developers in establishing the zone and private investors in establishing their investments in the zone.<sup>81</sup> Furthermore, efficiency of the zone authority should be maximized by constituting an independent board comprising representatives of key

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<sup>76</sup> OECD (n 53 above) 14.

<sup>77</sup> OECD (n 53 above) 14.

<sup>78</sup> OECD (n 53 above) 14.

<sup>79</sup> OECD (n 53 above) 15.

<sup>80</sup> OECD (n 53 above) 11.

<sup>81</sup> OECD (n 53 above) 15.

government ministries and private sector representatives, whether private developers or the investors.<sup>82</sup>

## **2.5 The treatment of SEZs within the context of international and regional agreements**

SEZs have been, and continue to be built around “low labour costs, trade preferences, and fiscal incentives”.<sup>83</sup> These issues encroach into domains of the international law such as trade law, labour law and import and export customs regulation. SEZ “operate within the wider context of FDI, international and regional trade and domestic economic policy.”<sup>84</sup> Accordingly, the formulation of SEZ regulation should not solely consider national objectives, but international best practice and principles of international law should also be considered. The general SEZ policy should also take into account obligations and standards set by institution such as the WTO, WCO and ILO. Enterprises that are located inside the SEZs are integrated into the domestic economy as well as the global economy. The modern SEZs emphasize the adoption of economic incentives that are WTO compatible as well as adherence to ILO core labour standards.”<sup>85</sup>

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<sup>82</sup> OECD (n 53 above) 15.

<sup>83</sup> T Farole (n 23 above) 9.

<sup>84</sup> ILO (n 9 above) 2.

<sup>85</sup> Botswana Special Economic Zone Policy (2010) [http://www.mti.gov.bw/webfm\\_send/278](http://www.mti.gov.bw/webfm_send/278)



### 2.5.1 World Trade Organisation

The interface between SEZs and the WTO framework relates to fiscal incentives and their potentially trade distorting effect.<sup>86</sup> SEZs are not directly mentioned in any WTO agreement but should be formulated, operate and regulated in accordance with WTO agreements including Agreement on Subsidies and Countervailing Measures (SCM Agreement) and the Agreement on Investment Measures Related to the Trade (TRIMS Agreement).<sup>87</sup>

SEZ incentives can be grouped into three main categories:

- (i) “measures that are consistent with the World Trade Organization, notably exemptions from duties and taxes on goods exported from special economic zones;
- (ii) measures that are prohibited or subject to challenge under World Trade Organization law, notably export subsidies and import substitution or domestic content subsidies; and
- (iii) measures where World Trade Organization consistency depends on the facts of the particular case.”<sup>88</sup>

The first concern with SEZs is that they may provide incentives that qualify as subsidies in the SCM Agreement. Even if not prohibited, incentives that both meet the definition of a specific subsidy and cause adverse effects as defined in the SCM Agreement may be legally challenged at the WTO dispute settlement body.<sup>89</sup> Notably, since 1 January 2003, developing WTO member countries have been prohibited from providing certain export subsidies, calling in some cases for adaptation of their current incentive schemes, including export subsidies provided in the context of EPZs producing goods.<sup>90</sup> However, the SCM prohibitions do not apply to LDCs or to countries that are listed in Annex VII to the SCM Agreement.<sup>91</sup> When

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<sup>86</sup> M Sornarajah (n 60 above) 116.

<sup>87</sup> S Creskoff and P Walkenhorst ‘Implications of WTO Disciplines for Special Economic Zones in Developing Countries’ abstract <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-4892>

<sup>88</sup> S Creskoff and P Walkenhorst (n 90 above).

<sup>89</sup> ILO (n 9 above) 5.

<sup>90</sup> ILO (n 9 above) 5.

<sup>91</sup> ILO (n 9 above) 5.

formulating their SEZ policies, LDCs should to an extent consider SCM Agreement prohibitions, in case of reclassification as a developing country.

## **2.5.2 World Customs Organisation**

The Revised Kyoto Protocol of the International Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Protocol) of the WCO is the main international instrument directly dealing with SEZs, or “free zones”, from an export and customs regulation perspective.<sup>92</sup> It provides a harmonized set of simplified and comprehensive customs procedures, which are targeted at facilitating legitimate international trade. It aims at achieving this facilitation through principles such as predictability, transparency, due process, maximum use of information technology, and modern customs.<sup>93</sup> Whether or not a country is a contracting party, the Kyoto Protocol is an important instrument as it provides best practice principles on customs issues.

Under Annex D of the Kyoto Protocol, free zones have been defined as “a 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 territory.”<sup>94</sup> The Protocol sets out both standard and recommended practices to be followed with respect to free zones, in eleven key areas which transcend the establishment, operation and termination stages in the lifecycle of a zone.<sup>95</sup> Two key issues stand out; the establishment and management of zones and the treatment of goods.

### **2.5.2.1 Establishment and management of the Zone**

To begin with, the Kyoto Protocol provides that the national legislation of a member-state should specify the requirements relating to the establishment, the admissible goods and the

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<sup>92</sup> Entered into force on 3 February 2006 to amend the International Convention on the Harmonisation of Customs Procedures of 1975.

<sup>93</sup> Preamble of Kyoto Protocol.

<sup>94</sup> Annex D of the Kyoto Protocol.

<sup>95</sup> These eleven key issues comprise; establishment and control of the zone, admission of goods, security, authorised operations, and goods consumed within and without the zone, duration of stay, removal of goods, transfer of ownership, assessment of duties and taxes and the closure of the free zone.

nature of the operations of a free zone.<sup>96</sup> This also includes laying down all the rules relating to customs control, including suitable requirements on the development, construction and layout of zones.<sup>97</sup> In the light of these rules, customs officials should be permitted to carry out checks at any time on such goods stored in a free zone.<sup>98</sup> In addition, the competent authorities allow processing or manufacturing operations in a free zone.<sup>99</sup>

### **2.5.2.2 Treatment of goods**

The Kyoto Protocol encourages faster and more efficient customs processes. Once a zone has been established and is operational, admission of goods directly imported into a free zone should be authorised. Rules on the refusal of goods on the grounds of “public morality or order, public security, public hygiene or health, or for veterinary or phytosanitary considerations; or the protection of patents, trademarks and copyrights” should also be set up.<sup>100</sup> Furthermore, it is recommended that customs should not require security for the admission of goods to a free zone.<sup>101</sup> National legislation should distinguish between goods that are consumed within the zone.<sup>102</sup> Finally, the duration of the stay of goods in a free zone should generally not be restricted other than under exceptional circumstances.<sup>103</sup>

## **2.6 International Labour Organisation**

SEZ labour policies should be in line with ILO standards such as the right to assemble and collective bargaining and should not overly dependence on foreign labour as opposed to domestic labour.<sup>104</sup> Labour and labour standards in SEZs, especially the EPZ model and other labour intensive SEZs, are a contentious issue.<sup>105</sup> In Bangladesh, for example, “no unions or

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<sup>96</sup> Article 2 of Annex D Kyoto Protocol.

<sup>97</sup> 4 of Annex D Kyoto Protocol.

<sup>98</sup> Article 3 and 4 of Annex D Kyoto Protocol.

<sup>99</sup> Article 12 of Annex D Kyoto Protocol.

<sup>100</sup> Article 6 of Annex D Kyoto Protocol.

<sup>101</sup> Article 10 of Annex D Kyoto Protocol.

<sup>102</sup> Article 13 of Annex D Kyoto Protocol.

<sup>103</sup> Article 14 of Annex D Kyoto Protocol.

<sup>104</sup> ILO (n 9 above) 5.

<sup>105</sup> ILO (n 9 above) 8.

strikes” is among the non-fiscal incentives offered by EPZs.<sup>106</sup> Accordingly, the ILO Committee on Employment and Social Policy has drafted an employment and social policy for EPZs.<sup>107</sup> The main concern is that EPZs will function at very low labour standards due to exemptions and relaxed labour regulation within the zones. The key areas which are vulnerable to abuse include; legal restrictions on trade unions, the relaxed or no enforcement of labour legislation and the absence of workers’ organizations representation.<sup>108</sup> Further, gender-related form of discrimination in hiring, remuneration, benefits, career development, accommodation for women workers, working hours, pregnancy, maternity leave or childcare, also present legal concerns.<sup>109</sup>

The ILO Committee of Experts on the Application of Conventions and Recommendations has noted discrepancies between the obligations undertaken in conventions ratified by member states, and their national legislation and practice. Concerns have been raised about the right to organize and join organizations in Namibia, Nigeria and Togo.<sup>110</sup> Notably, since 1998, conclusions have been adopted by the ILO Committee on the Application of Standards and Recommendations in relation to some of these concerns.<sup>111</sup>

## 2.7 Conclusion

This chapter defined the concept of SEZs and discussed their nature and the models or forms which they can take. From the discussion, it is evident that there are numerous benefits to the use of SEZs ranging from economic development, social and geo-political developments, technology transfer to the testing of new laws and policies. It is further evident that although there is no “one size fit all”, the adoption of international best practice is a crucial tool to assist

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<sup>106</sup> ILO (n 9 above) 8.

<sup>107</sup> The ILO has numerous meeting and recommendations with respect to EPZs including the ILO: Labour and social issues relating to export processing zones (Geneva, 1998), TMEPZ/1998; the Tripartite Meeting of Export Processing Zones-Operating Countries (Geneva, 28 September-2 October 1998), TMEPZ/1998/5; the ILO: “Free trade zones” in Employment effects of multinational enterprises in developing Countries (Geneva, ILO, 1981); ILO/UNCTC: “Economic and social effects of multinational enterprises in export processing zones” (Geneva, ILO, 1988); and A.S. Oberai, A. Sivananthiran and C.S. Venkata Ratnam (eds.): “Labour issues in export processing zones in South Asia: Role of social dialogue” ILO (n 9 above) 1.

<sup>108</sup> ILO (n 9 above) 7.

<sup>109</sup> ILO (n 9 above) 9.

<sup>110</sup> ILO (n 9 above) 7.

<sup>111</sup> ILO (n 9 above) 8.

countries in the formulation of their local SEZ governing frameworks as well as with implementation. International best practice make SEZs more likely to succeed.

International best practice principles such as those documented by the OECD, and articulated by the World Bank are not binding “hard law” but soft law” of particular importance as they have been tried and tested. The study paid particular emphasis to the incentive, regulatory and policy regimes. From the forgoing, it can be concluded that although SEZs are primarily national legal creatures, they function in states, which in turn function within a global legal framework. As such international standards and commitments should be adequately considered, and were relevant, embodied in the SEZ legislative framework.

## CHAPTER 3

### SEZs IN DRC AND THE UNDERLYING LEGAL FRAMEWORK

#### 3.1 Introduction

After elaborating on SEZs as an umbrella concept and their relationship with different fields of international law in the previous chapter, this chapter will focus on SEZs from the context of the DRC. This chapter evaluates the DRC's existing SEZ legislative framework and tests whether it is in line with international best practice. The discussion firstly examines the framework for free industrial zones in the 1980s, and moves on to contemporary SEZs developed under the Growth Poles Project. It examines the current national legislative and regulatory system of the DRC and attempts to identify some of the key challenges in this system that could undermine the performance of SEZs. The chapter ends with an assessment of the anticipated new SEZ legislation.

#### 3.2 The Free Industrial Zones Legislative Framework

The development and use of SEZs is not novel to the DRC: the previous investment regime provided for the establishment of free industrial zones, also known as free zones or FTZs, under Law No. 81-010 of 2 April 1981, later governed by the Investment Code Law No. 86-028 of 5 April 1986. Both have now been suspended by the current Investment Code Law No. 004/2002 from 21 February 2002. Free zones in this context are areas in which goods and services are exempt from all duties and taxes on their input and output and are considered as being outside the frontiers of the country for customs purposes.<sup>112</sup>

In the 1980s the DRC first experimented with free industrial zones by establishing the ZOFI through the enactment of Decree No. 8 of April 15, 1981. The main objective of the ZOFI was attract FDI. It targeted energy-intensive and export-oriented industries such as aluminium

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<sup>112</sup> 'Journal Officiel De La République Démocratique Du Congo' (20 January 2012).

smelters and producers of nitrogenous fertilizers.<sup>113</sup> Under the 1981 Decree, companies would only be admitted into the zone if

- they had a minimum power consumption of 10 MW per year during 3000 hours or equal to 10% the added value of the company;
- their production was exported; and if
- at least 80% of the investment was financed by foreign funds if the promoters of the company were all foreigners.<sup>114</sup>

According to Mumene and Ngoy, investors could benefit from a constant supply of electricity from the Inga Dam and a series of fiscal incentives. They provide that investors could benefit with exemptions (i) special tax on salaries paid to the expatriate staff to the start date marketing of production; (ii) total tax exemption during the first six years of contribution on investment income,<sup>115</sup> (iii) tax on concession area land; (iv) customs duties and import taxes with the exception of the statistical tax for machinery, tools and materials necessary to achieve investment; (v) duties and export taxes, except tax levied on finished and semi-finished exports.<sup>116</sup> Investors who chose to be subject to this incentive system could not benefit from the general Investment Code.

Despite its promise, the ZOFI was not successful, like many of these zones established at the time. The critical weaknesses with the free industrial zones in Zaïre were the unattractive incentives, poor locations and the challenging environment elsewhere in the country.<sup>117</sup>

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<sup>113</sup> African Development Bank 'Democratic Republic of Congo: Economic and Sector Work Regional Economic Development In Bas-Congo In The Context Of Decentralization In The Democratic Republic Of Congo' (2009) 17, [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/DRC\\_Etude%20decentralisation\\_english\\_01.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/DRC_Etude%20decentralisation_english_01.pdf)

<sup>114</sup> M Mumene & SM Wa Ngoy *La politique industrielle au Zaïre et la zone franche d'Inga, vers une nouvelle stratégie d'industrialisation?* (1984) 83.

<sup>115</sup> This exemption is subject to a 50% reduction from the seventh to the fifteenth year, then 25% of the fifteenth to the thirtieth year provided that the income and savings are reinvested in the country.

<sup>116</sup> M Mumene & SM Wa Ngoy (n 114 above) 85 – 86.

<sup>117</sup> EF Kisangani & SF Bobb *Historical Dictionary of the Democratic Republic of the Congo* (2010) & World Bank 'Zaire: A Review of Governmental Expenditure, Report No. 8995-ZR' (1991) 99, [http://www-wds.worldbank.org/servlet/WDSContentServer/IW3P/IB/1991/06/07/000009265\\_3960929160714/Rendered/PDF/multi\\_page.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/IW3P/IB/1991/06/07/000009265_3960929160714/Rendered/PDF/multi_page.pdf)

International best practice has shown that zones which are specifically created to bring development to less developed regions of a host state are generally a weaker model. In view of this, it is often the case that such regions within the host country are at a lesser level of development due to challenges including poor essential infrastructure, limited access to skilled labour, and distances from markets and other inputs.<sup>118</sup> To attract investment and for costs to be recovered despite these challenges, SEZs would have to either offer extensive subsidies or require levels of investment in public infrastructure that are not economically viable.<sup>119</sup> This made the ZOFI unsuccessful.

SEZs function within the national framework, despite being somewhat separate in some respects, depending on the legal policy and model of zone adopted. This does not negate the role of the general investment climate in the broader economy of a host country. Accordingly, the more business friendly the general investment environment is, the more likely an SEZ has to stimulate economic activity both within and outside of the zone.<sup>120</sup> This is especially so with respect to the exchange rate of the country and the access to labour and other inputs. Additionally, the SEZ may cushion an enterprise from a generally bad investment environment but cannot fully protect them from infrastructural challenges, the lack of good governance and a weak legal system in the host country, among other things. With regard to the exchange rate, an overvalued local currency negatively affects competition when local inputs and labour costs make up a significant proportion of total costs.<sup>121</sup> Free industrial zones in Zaire did not shield investors from the general business environment elsewhere in the country.

### 3.3 From Free Industrial Zones to SEZs

Despite the failure of the ZOFI to attract FDI, the DRC has revived the idea of creating SEZs. In 2007, the Minister of Industry requested assistance from the World Bank Group to

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<sup>118</sup> CDE 'Special Economic Zones: Lessons for South Africa from international evidence and local Experience' (2012) 4  
[http://dspace.cigilibrary.org/jspui/bitstream/123456789/33070/1/SEZs\\_\(full\\_report\)\[1\].pdf?1](http://dspace.cigilibrary.org/jspui/bitstream/123456789/33070/1/SEZs_(full_report)[1].pdf?1) (accessed on 1 December 2013).

<sup>119</sup> CDE (n 118 above) 4.

<sup>120</sup> CDE (n 118 above) 3.

<sup>121</sup> CDE (n 11 above) 3.



developing a framework for SEZs.<sup>122</sup> In response, the IFC, launched the SEZ Program to assist the government establish a privately-managed pilot SEZ, create jobs and alleviate poverty by reducing the cost of goods and services while promoting competition between suppliers.<sup>123</sup>

This programme has since been assigned to the World Bank WGPP which includes the establishment of the Maluku SEZ as the pilot project.<sup>124</sup> The Maluku SEZ is aimed to facilitate access to industrial land, provide critical infrastructure, and a transparent environment for doing business.<sup>125</sup> In effect, these objectives are geared towards the attraction of investment in sectors and regions that have been long neglected.<sup>126</sup> The promotion of foreign investment, including FDI, is an ideal that is expressed in the Constitution of the DRC. Specifically, Article 35 which guarantees private property rights, also provides that the State should encourage both national and foreign private investments. This will be achieved by increasing productivity and employment in selected value chains in target zones in the DRC.<sup>127</sup> The Project consists the following three sub-sets; (i) facilitation of a PPP (US\$1.5 million), (ii) strengthening the Capacity of CAZES (US\$3.5 million), (iii) physical Infrastructure (US\$22 million).<sup>128</sup>

### 3.4 The Current SEZ Legislative Framework

The DRC does not currently have a comprehensive legal framework that governs SEZs, but the framework currently comprises numerous Codes that deal with different issues relating to

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<sup>122</sup> IFC *Democratic Republic Of Congo Special economic zone program: Progress Report July - December 2010* 2010 2

<https://www.wbginvestmentclimate.org/publications/upload/DRC-SEZ-Report-July-December-2010-for-Internet.pdf> (accessed on 18 November 2013).

<sup>123</sup> IFC (n122 above) 2.

<sup>124</sup> The first component is agriculture value chains development in Bas-Congo. The second component is special economic zone of Maluku. The third component is proactive business development. The fourth component is coordination, monitoring, communication and impact. Dem Rep Congo - Western Growth Poles, World Bank, <http://www.worldbank.org/projects/P124720/dem-rep-congo-western-growth-poles?lang=en>

<sup>125</sup> Integrated Safeguards Data Sheet, World Bank, [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/AFR/2013/05/06/090224b081b87ed2/1\\_0/Rendred/INDEX/Integrated0Saf0owth0Poles000P124720.txt](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/AFR/2013/05/06/090224b081b87ed2/1_0/Rendred/INDEX/Integrated0Saf0owth0Poles000P124720.txt)

<sup>126</sup> IDC 'World Bank Group Supports Better Investment Climate in DRC through Special Economic Zone' <http://ifcext.ifc.org/IFCExt/pressroom/IFCPressRoom.nsf/0/ADBC31D7647E702C85257611005460D5?OpenDocument>

<sup>127</sup> World Bank 'Dem Rep Congo - Western Growth Poles' <http://www.worldbank.org/projects/P124720/dem-rep-congo-western-growth-poles?lang=en>

<sup>128</sup> World Bank (n 127 above).

SEZs. The Maluku SEZ was enacted by Decree No. 12/021. In addition, both ANAPI (the investment agency of the DRC) and CASEZ (the zone authority) have provided that the Maluku SEZs will be specifically governed by a unique legal framework that offers a conducive business environment for local and foreign investors.<sup>129</sup> This includes the automatic application of the Investment Code, access to infrastructure and simplified and transparent administrative, customs and land concessions procedures.<sup>130</sup>

### 3.4.1 The DRC Investment Code

The 2002 Investment Code was the result of an overall reform of key national legislative and administrative systems that replaced outdated laws, some of which stemmed back from the colonial era. It aims to encourage investment and to generally minimise the restrictions on business transactions nationwide.<sup>131</sup> It overcomes former hurdles through a “one-stop agency” called the ANAPI;<sup>132</sup> the agency is tasked with simplifying and facilitating investment procedures while ensuring their transparency.<sup>133</sup> The Investment Code aims to provide sound business conditions, benefits, and clarify the general rules applicable to direct investments made by both local and foreign investors.<sup>134</sup>

The Investment Code does not expressly or directly provide for SEZs, but investments created in DRC SEZs automatically govern SEZs. The extent to which the Code is applicable is somewhat unclear. It provides for a series of protections and incentives which would be of benefit to both local and foreign investors. Intrinsicly, the central principles at the heart of the Code is firstly the principle of national treatment and secondly, the provision of pro-investor incentives, tax and export incentives.

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<sup>129</sup> CASEZ ‘Call for investors interested in developing operations in the proposed Special Economic Zone at Maluku, Kinshasa province’ (2013) <http://cazesrdc.net/index.php/activites-de-la-cazes/157-call-for-investors-interested-in-developing-operations-in-the-proposed-special-economic-zone-at-maluku-kinshasa-province>

<sup>130</sup> ANAPI ‘Official communique inviting investors to join the special economic zone of Maluku/Kinshasa’ 2012

<http://www.investindrc.cd/en/spip.php?article702> (accessed on 18 November 2013).

<sup>131</sup> ‘DRC: 2010 Investment Climate Statement’, <http://www.cablegatesearch.net/cable.php?id=10KINSHASA92>

<sup>132</sup> ‘Decret N° 065/2002 Du 05 Juin 2002 *Portant Statuts, Organisation Et Fonctionnement De L’agence Nationale Pour La Promotion Des Investissements, En Sigle « Anapi »*’

[http://www.leganet.cd/Legislation/Tables/droit\\_economique.htm](http://www.leganet.cd/Legislation/Tables/droit_economique.htm)

<sup>133</sup> ‘DRC: 2010 Investment Climate Statement’, <http://www.cablegatesearch.net/cable.php?id=10KINSHASA92>

<sup>134</sup> Article 1.

### 3.4.1.1 “Investment” and “Investor”

To begin with, before qualifying as a beneficiary of the incentives and protections under the Investment Code, one should qualify as an “investment” made by an “investor”. The Investment Code defines both direct investment and FDI. Direct investment are “all investments coming from the field of application of this law envisaged through a new enterprise or existing enterprise whose objective is to put in place a new capacity or to increase production capacity, expand the range of products or to improve the quality of products and services.”<sup>135</sup>

FDI comprises all investments in which the foreign participation in the share capital of the direct investment enterprise is at least 10%. As such, a “direct investor” is any investor that makes a direct investment, while “foreign direct investors” are “all natural persons who are not of Congolese nationality or of Congolese nationality and resident in a foreign country and all natural persons public or private whose corporate headquarters are not within the Congolese territory and are carrying out a direct investment in the Congo”.<sup>136</sup> Investments are not automatically guaranteed the general protections under the Code but to qualify under the general system, they should fulfil the following conditions:

- i) be an economic entity of Congolese rights;
- ii) minimally amount to the equivalent of US\$200.000;
- iii) respect the law regarding protection of environment and nature ;
- iv) provide training for local personnel in specialised technical and management posts; and
- v) guarantee a value-added rate of at least 35%.<sup>137</sup>

Unlike other investment codes which provide similar treatment within the entire territory of a country, the location of an investment has a bearing on the fiscal incentives. The Investment Code provides for incentives that are influenced by the region in which the investment is made. There are three economic regions, classified according to the degree of their economic

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<sup>135</sup> Article 2.

<sup>136</sup> (n 135 above).

<sup>137</sup> Article 8.

development: (A) Kinshasa; (B) Bas Congo, Lubumbashi, Likasi and Kolwezi; and (C) Bandundu, Equator, Eastern Kasai, Western Kasai, Maniema, Kivu North, Kivu South, Eastern Province, and Katanga.<sup>138</sup> The duration of certain fiscal incentives is region-dependent: investments benefit for three years in region (A), four years in (B) and five years in (C).<sup>139</sup> It is not clear whether this system also applies to SEZs.

### 3.4.1.2 General incentives under the Investment Code

The incentives offered under the Investment Code can be broadly divided into general incentives comprising general protection afforded to investors and special incentives consisting of fiscal and customs incentives. As the first general incentive or protection, the Code affords foreign investors that wish to establish in the SEZ in the DRC Maluku equal treatment to national investors. The regulation provides that there should not be any discriminating or unjustified distinction between local and foreign investors, except in some specific cases provided in law, such as with labour and related taxes.<sup>140</sup> Foreign investors hence receive similar treatment to local individuals or companies, subject to the application of the same principle of equal treatment by the state in which the foreign individual or company is a citizen.<sup>141</sup> Additionally, investors are entitled to equal treatment among themselves, except for agreements signed with other states such as bilateral investment treaties.<sup>142</sup> The State excludes arrangements made under customs unions, common markets or any other form of regional economic organisation.<sup>143</sup> In addition, investors are national treatment and fair and equitable treatment, in accordance with the principles of international law.<sup>144</sup> Investors cannot be expropriated except for a public purpose and subject to the payment of a fair and equitable compensation.<sup>145</sup>

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<sup>138</sup> Article 2(f).

<sup>139</sup> Article 9.

<sup>140</sup> DRC: 2010 Investment Climate Statement, <http://www.cablegatesearch.net/cable.php?id=10KINSHASA92>

<sup>141</sup> Article 23.

<sup>142</sup> Article 24.

<sup>143</sup> Article 24.

<sup>144</sup> Article 25.

<sup>145</sup> Article 26.

### 3.4.1.3 Special incentives under the Investment Code

The Investment Code contains various pro-business incentives, including tax breaks and duty exemptions that are dependent upon various factors including the location and type of enterprise, the extent of jobs creation, training and promotion of local staff, and the export-producing potential of the operation.<sup>146</sup>

As the primary customs advantage offered under the Investment Code is the total exemption of fees and taxes for the import of assets essential for new or existing enterprises including machinery, tools, new material, and spare parts not exceeding 10% of the CIF value of the said equipment.<sup>147</sup> This excludes an administrative tax amounting to 5% of the CIF value of the imported equipment.<sup>148</sup> Second hand heavy engines, ships and aircrafts are entitled to a total exemption from import tax.<sup>149</sup> To benefit from this, companies must make an application to be considered as approved companies and the goods in question should be among those listed in the relevant inter-ministerial decree.

Another customs advantage that approved investments can benefit from relates to an exemption from fees and taxes at importation, however enterprises can only benefit from this if the goods in question are not manufactured in the DRC and the price prior to the reduction of tax on the local product is 10% higher than the same imported product.<sup>150</sup> Finally, approved investments can benefit from exemption from fees and taxes at exportations at the first exportation, where the exportation of all or part of the finished processed or semi-processed products, are exported under conditions favourable for the balance of payment, evidenced by exportation documents.<sup>151</sup>

Subject to regulations on digressive repayments (sliding scale of charges), approved investments can benefit from the redemption of investments in approved projects in

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<sup>146</sup> Article 1.

<sup>147</sup> Article 11.

<sup>148</sup> (n146 above).

<sup>149</sup> (n146 above).

<sup>150</sup> (n146 above).

<sup>151</sup> Article 12.

socioeconomic infrastructure such as schools, hospitals, sporting facilities and roads.<sup>152</sup> Approved limited liability companies, can benefit from exemptions from certain proportional fees, during their establishment or the increase of their share capital.<sup>153</sup> The Code further provides for exemption from contributing on concession surface area and on property linked to the approved investment, as provided in Title II of regulatory law No. 69006 of 10 February 1969.<sup>154</sup> The exemption comes into effect on the first January of the year after the availability of title deeds, change in terrain or the construction of building, whichever occurs within the first six months of acquisition.<sup>155</sup> To benefit from the customs, fiscal and parafiscal incentives in the Investment Code, they should make the relevant application to ANAPI.

### **3.5 Shortcomings of the current system**

The current SEZ framework of the DRC does not meet international best practice and may result in an experience similar to that under the FTZ era. Firstly, the country does not presently have a comprehensive SEZ law that dictates the policies to be adopted when creating SEZs. As such there are presently neither rules setting out the role and designation of key role players in zone creation and management, nor procedures with respect to the selection, designation, regulation, and operation of SEZs. Furthermore, there is very little information available to foreign investors about the special incentives and infrastructure available to them. The provision of these special benefits has only been made in statements by the investment agency.

Investors are hence subject to the Investment Code which is not unique to SEZs. This raises the question of how special the Maluku SEZ actually is. However the extent of applicability of the provisions of the Code is not clear. For instance, the Code differentiates the duration of incentives depending on which economic region the investment is located. Theoretically this raises questions as it could lead to investors situating in regions that provide incentives for longer periods of time, and which are in essence no more different than the SEZ. Further on the issue of incentives, investors need to apply for every set of incentives under the Investment

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<sup>152</sup> Article 14.

<sup>153</sup> Article 15.

<sup>154</sup> Article 16.

<sup>155</sup> Article 16.

Code. Finally, the Maluku SEZ has not only been created to attract FDI but also to strengthen the private sector, but there the private sector has only been marginally involved.

In summary, the true challenge with the current system is its lack of clarity: without a well-defined set of clear rules for all stakeholders of an SEZ, predictability and transparency cannot be guaranteed.

### **3.6 Towards a new legal and regulatory framework**

In April 2010 the IFC proposed a draft SEZ law, which purportedly “incorporated best international practice and took into account local practice”. The draft was approved, with amendments, by the Government's Law Commission.<sup>156</sup> The proposed new law aims to simplify administrative procedures, facilitating investment disputes, and create a simple and transparent business environment.<sup>157</sup> Unlike previously, the new law is a single legislation that sets out the functioning, objectives and designation of SEZs and the rules governing companies operating therein.<sup>158</sup> Tax and customs provisions, as they are dealt with in the Investment Code.<sup>159</sup> In terms of the new regime, an investment is the commitment of capital with the intention of generating profit or economic benefit, while assuming the risks associated. Investments are:

- i) shares or other forms of participation in an SEZ Company; and
- ii) rights arising from a contract or agreement involving an investor as a party, including turnkey contracts, management contracts, production and concession agreements.<sup>160</sup>

The new law introduces the rights and obligations of SEZ investors which include to undertake a lawful economic activity; to enter into any contract with the developer or manager of the SEZ, other companies; to extend their field of activity within an SEZ, without any further formality of registration; to enjoy any other right under therein or implementing legislations. Investors are however still entitled to fiscal benefits under the Investment Code.<sup>161</sup> As such the

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<sup>156</sup> IFC (n 122 above) 4.

<sup>157</sup> Article 1.

<sup>158</sup> Article 1.

<sup>159</sup> Article 1.

<sup>160</sup> Article 2(14).

<sup>161</sup> Article 34.

new SEZ regime will not offer unique fiscal incentives that are more favourable than the rest of the country. The law does propose the establishment a special system of payment of taxes and administrative fees either within the zone or by a designated administrative process.<sup>162</sup> The law also proposes simplified control procedures for goods originating from or destined for SEZs, exemptions from customs deposits on goods stored within the SEZ and the spreading out of tax payments in case of cash flow difficulties of SEZ taxpayers.<sup>163</sup> The final change which the new law introduces is that it clearly sets out the role and functions of the AZES. Accordingly, AZES will be tasked to regulate and approve developers, managers and investors in SEZs, and ensure the proper implementation of this Act.<sup>164</sup> AZES can only designate private developers, foreign and domestic developers, or public-private partnerships only as SEZs.<sup>165</sup>

### 3.7 Conclusion

This chapter evaluated the legislative framework governing SEZs in the DRC. It revealed that a previous attempt in the 1980s failed due to the lack of attractive incentives and influence from the broader business environment. The country has currently established an SEZ Project and developed an overarching SEZ law. The new law sets out the relationship between the key players in SEZs and the rights and obligations of investors, however it does not clarify all the issues discussed in this chapter. The key concern which has not been adequately addressed is the fiscal incentive framework. It has been revealed that SEZ investors are still only entitled to the general benefits under the Investment Code.

It has been indicated that, although the new law may indeed solve some of the *lacunae* in the present system, some challenges remain, such as the provision of an incentive system that creates an actual benefit that cannot be experienced anywhere else in the country. The concern of the author is that the SEZ framework does not adequately provide for fiscal and non-fiscal incentives that will give businesses a reason to set up in them. The exact non-fiscal incentives which investors will benefit from is also not clear. The chapter is thus concluded by asking the

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<sup>162</sup> Article 38.

<sup>163</sup> Article 35.

<sup>164</sup> Article 5.

<sup>165</sup> Article 6.



pertinent question: what will the new regime really offer investors that will be of use to them and that will make them choose SEZs in the DRC over the rest of the continent?

## CHAPTER 4

### DELIVERING ON SEZs: LESSONS FROM SOUTH AFRICA

#### 4.1 Introduction

This chapter presents a study of the South African challenges with Industrial Development Zones (IDZs) and its transition to a broader SEZ regime, in an attempt to draw lessons for the DRC. The choice of South Africa as a case study is not only motivated by the author's desire to draw from African experience, but also by the fact that both the DRC and South Africa have a robust trade and investment relationship, which extends to a commitment to share experience with respect to SEZs.<sup>166</sup>

#### 4.2 South African IDZ Framework

In 1997, the South African government adopted a policy aimed at the creation of IDZs.<sup>167</sup> IDZs are defined as 'insulated export areas strategically linked to a port or airport', that 'offer fiscal and non-fiscal incentives to industrialists so that their exports can be internationally competitive'.<sup>168</sup> Due to negative perceptions of SEZs in Asia and elsewhere at the time, the South African government chose to name them IDZ, but they are a species of SEZs. The adoption of the IDZ policy in South Africa came at a time when the country was going through a "double-transition" which comprised both a political transformation from apartheid to democracy and a shift towards economic deregulation and export-led growth.<sup>169</sup> In line with the economic transition, the central conception around the creation of IDZs was the attraction of FDI for export-oriented manufacturing.<sup>170</sup>

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<sup>166</sup> 'SA commits to trade with DRC, Creamer Media Engineering News' (18 September 2013)

<http://www.engineeringnews.co.za/article/sa-commits-to-trade-with-drc-2013-09-18>

<sup>167</sup> ILO 'Export Processing Zones: Comparative Data from China, Honduras, Nicaragua and South Africa' (March 2011) 12 [http://www.ilo.org/wcmsp5/groups/public/---ed\\_dialogue/---dialogue/documents/publication/wcms\\_158364.pdf](http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---dialogue/documents/publication/wcms_158364.pdf)

<sup>168</sup> V Tang 'Zoning in on South Africa's Industrial Development Zones' (October 2008)

[http://www.tips.org.za/files/Tang\\_Final\\_Zoning\\_in\\_on\\_SAfrica\\_IDZs\\_24\\_Oct\\_2008.pdf](http://www.tips.org.za/files/Tang_Final_Zoning_in_on_SAfrica_IDZs_24_Oct_2008.pdf)

<sup>169</sup> ILO (n 166 above).

<sup>170</sup> SADC 'South Africa Investment Incentives' <http://www.sadc.int/information-services/tax-database/south-africa-investment-incenti/>

The main legislation governing IDZs is the Manufacturing Development Act No. 187 of 1993. The Act broadly deals with the development and administrative aspects such as designation and administration of IDZs, functions of provisional and other operators, development and operation of IDZs, customs rules and procedures, and dispute settlement.<sup>171</sup>

For tax and customs administrative purposes, IDZs contain customs controlled areas (CCAs) and customs secured areas (CSAs) which provide different customs benefits and are primarily controlled by the Minister of the South African Revenue Services and exempt businesses therein from VAT and import duties on machinery and some assets and other duties.<sup>172</sup> Industries falling within the rest of the IDZ, falling outside the CSAs and CCAs, are controlled by the Minister of Trade and Industry.<sup>173</sup> The Customs and Excise Act 91 of 1964 (CEA) is the main customs as it broadly provides for the levying of customs and excise duties and surcharges.<sup>174</sup> Specifically, section 21A of the CEA provides for the administration of the CCAs falling within an IDZ and provides for the liability for duty, or lack thereof, in respect of goods specified in the section.<sup>175</sup> In addition to the CEA, the VAT Interpretation Note 40 dated December 2007 provides for treatment of the supply of goods and/or services to and/or from a CCA of an IDZ.<sup>176</sup>

There are various incentive policies which foreign investors, including those located in an IDZ could take advantage of. These incentives and tax breaks relate to subject areas such as infrastructure development, research and technology, environmental and sustainable business and machinery. As a starting point, section 11D of the Income Tax Act No. 58 of 1962 provides for a deduction from a taxpayer's taxable income of expenditure actually incurred in respect of scientific or technological research and development.<sup>177</sup> IDZs which conduct such research and

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<sup>171</sup> Act No. 187 of 1993 [file:///C:/Users/User/Downloads/21803%20\(1\).pdf](file:///C:/Users/User/Downloads/21803%20(1).pdf)

<sup>172</sup> C Baissac 'SEZs for South Africa' (February 2010) 63.  
[http://issuu.com/claudebaissac/docs/sezs\\_for\\_south\\_africa\\_-\\_2010](http://issuu.com/claudebaissac/docs/sezs_for_south_africa_-_2010)

<sup>173</sup> C Baissac (n 171 above).

<sup>174</sup> Long title of Act No. 91 of 1964, <http://www.acts.co.za/customs-and-excise-act-1964/>

<sup>175</sup> Section 21A(1) and (9) of CEA, <http://www.acts.co.za/customs-and-excise-act-1964/>

<sup>176</sup> South African Revenue Services, <http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-40-Arc-43%20-%20IN40%20Issue%201%20Archived%20on%2030%20March%202012.pdf>

<sup>177</sup> A Erasmus 'Trade Zones: Recommendations for South Africa' (2011) 15,  
[file:///C:/Users/User/Downloads/saia\\_sop\\_90\\_erasmus\\_%2020110901.pdf](file:///C:/Users/User/Downloads/saia_sop_90_erasmus_%2020110901.pdf)

development, as defined in the Income Tax Act, can therefore apply for such deductions. Further, section 12I of the Income Tax Act provides for an Industrial Policy Incentive under which investors may be afforded tax incentives aimed at encouraging investment in large industrial projects by granting an additional investment allowance of either 35% or 55% of the cost of qualifying investment assets.<sup>178</sup>

With respect to infrastructure, the CIP provides cash grant incentives which stem from 10% to 30% of the construction cost for the development of essential infrastructure to support strategic investment projects.<sup>179</sup> In the manufacturing sphere, investors can benefit from a grant of 15% to 30% payable over two years, covering the value of qualifying investment costs in assets required for establishing a new production facility or expanding an existing production facility, including costs of machinery, equipment, commercial vehicles, land and buildings.<sup>180</sup> This two year grant falls under the Manufacturing Investment Programme. Large-scale municipal infrastructure projects delivered by the private sector could qualify for grants under the National Treasury incentive programme, although it is mainly directed towards funding of the capital cost of municipal projects by municipalities.<sup>181</sup>

Investors can also benefit from climate change, sustainability and tourism incentives. Section 12L of the Income Tax Act provides for an energy efficiency tax allowance which requires an investor to obtain an ‘energy efficiency savings certificate’, and which can be described more as an energy reduction incentive, than merely an electricity usage reduction incentive.<sup>182</sup> Investors can also take advantage of the carbon credits under the Clean Development Mechanism of the Kyoto Protocol for reductions in carbon emissions.<sup>183</sup> Carbon credits are considered a form of diversified financial instrument and FDI, which in the South African context constitute an “attractive form of financing to South African companies moving towards the use of cleaner production techniques”.<sup>184</sup>

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<sup>178</sup> A. Erasmus (n 176 above) 16.

<sup>179</sup> A. Erasmus (n 176 above) 15.

<sup>180</sup> A. Erasmus (n 176 above) 16.

<sup>181</sup> A. Erasmus (n 176 above) 15.

<sup>182</sup> A. Erasmus (n 176 above) 16.

<sup>183</sup> A. Erasmus (n 176 above) 16.

<sup>184</sup> A. Erasmus (n 176 above).

Lastly the tourism support program provides grants of 15% to 30%, covering costs of establishment, operation and expansion of existing tourism linked investments.<sup>185</sup> The aim of this grant is to support the development of tourism enterprises, which will in turn stimulate job creation and encourage a geographic spread of tourism investment.<sup>186</sup> For the tourism support programme and the other incentives discussed above, investments must be “qualifying investment” under the different investment packages. The benefits are not automatic rights acquired by virtue of setting up in an IDZ but arise from approvals of applications made under the different incentive packages.

### 4.3 Learning from a failed experience: South Africa’s Industrial development zone

Under the IDZ program South Africa designated and licensed the following four IDZs:

- Coega IDZ in the Eastern Cape (2001),
- East London IDZ in the Eastern Cape (2002),
- OR Tambo International Airport IDZ in Gauteng (2002), and
- Richards Bay IDZ in KwaZulu-Natal (2002).<sup>187</sup>

Reports such as those indicating that “the South Africa’s four IDZs have injected R14.9 billion into the local economy and created around 48,000 jobs, their achievements have not been in line with initial target” may give one the impression that the IDZs were a valuable industrial and investment tool for the country.<sup>188</sup> However, it has been accepted that the IDZ program was in fact generally unsuccessful. The determination of whether an SEZ is successful, and the extent of its success does not solely relate to the money that appears to be generated on the face of it, but also by whether the zone has achieved its intended objectives. The IDZs failed to attract the intended levels of FDI. The Coega IDZ has attracted a total of 17 operational

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<sup>185</sup> A. Erasmus (n 176 above).

<sup>186</sup> A. Erasmus (n 176 above).

<sup>187</sup> A. Erasmus (n 176 above) 6.

<sup>188</sup> Deloitte ‘Special Economic Zones improving on the limited success of the IDZ concept’ 1 [http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Assets/Documents/Deloitte\\_Special\\_Economic\\_Zones\\_2013.pdf](http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Assets/Documents/Deloitte_Special_Economic_Zones_2013.pdf) (accessed on 1 December 2013).

investors, valued at R9.2 billion and generated 2,837 operational jobs; however, the majority of the investors merely relocated from other industrial parks in South Africa. Further, as at July 2011, the East London IDZ generated approximately 1,450 jobs, but each job created reportedly required close to R1 million in investment spending.<sup>189</sup> As at October 2011, the Richards Bay IDZ attracted investments valued at R850 million and generated 269 operational jobs, nevertheless it faces a number of logistical constraints that undermine its viability.<sup>190</sup> Finally, the OR Tambo IDZ has not generated any concrete investments.<sup>191</sup>

Despite many reasons for their failure, three key issues stand out from the South African IDZ experience. These broadly relate to the ineffective legal policy framework, and specifically in respect of the incentive packages offered, management and operation of the IDZ. IDZs as a subset of SEZs had potential from a conceptual point of view, ended up sucking large amounts of government funds out of the economy without really creating the initially intended FDI that they were intended to attract.

#### **4.3.1 Policy framework**

From their conception, the IDZs have been criticised for lacking a comprehensive legal policy framework, which in turn has resulted in deficiencies in governance, planning, implementation, management, and operation.<sup>192</sup> For instance, close to a decade after the policy's inception, none of the IDZs offered a CSA or a one-stop centre for customs duties and VAT regulatory requirements.<sup>193</sup> One cause has been the lack of a dedicated legislation, driven and represented at the highest level in government, as international best practice suggests.<sup>194</sup> In practice, only a subset of the South African Department of Trade and Industry was responsible for IDZs.<sup>195</sup>

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<sup>189</sup> CDE (n122 above).

<sup>190</sup> CDE (n122 above).

<sup>191</sup> CDE (n122 above).

<sup>192</sup> CDE (n122 above).

<sup>193</sup> CDE (n122 above).

<sup>194</sup> C Chinguno 'South Africa's Experience with Special Economic Zones (2011) 21.

<sup>195</sup> C Chinguno (n 193 above).

### 4.3.2 Incentive scheme

The IDZ system has been criticised for not providing investors with special fiscal and other incentives, since it did not streamline or facilitate administrative procedures. The tax and other fiscal incentives previously discussed in this chapter are not specific to the IDZs, but could be offered to other investors as well. They have been perceived as overly onerous as investors had to make applications for each kind of incentive.<sup>196</sup> This system of application for incentives was too complicated because there were too many bodies to apply to as well as too many different application procedures. This negates the objective of creating an environment that is conducive for the attraction of FDI. The IDZ framework did not provide incentives that were unique to the IDZ, due to fears they would distort the economy, but it has meant that IDZs have not been able to offer investors a more attractive environment.<sup>197</sup> In addition to the lack of attractive fiscal incentives, IDZs did not provide relaxed social, labour, and environmental legislation than those which were in force elsewhere in the country.<sup>198</sup>

### 4.3.3 How “Special” is the Economic Zone?

SEZs should primarily create a special fiscal, infrastructural or legal system. Getting the right mix of incentives is determined from zone to zone, however the key is that the economic zone should actually provide a ‘special’ system, and not be merely called an SEZ. In this respect, the South African IDZs have been viewed as not actually constituting SEZs as they do not offer anything extraordinary to investors when compared to other industrial parks in the country.<sup>199</sup> They do not provide fiscal incentives or legal rules that are particularly different from those offered to investors elsewhere. They primarily aim to provide “world class infrastructure”, nonetheless most of the infrastructure in question is not substantially different from that elsewhere in the country.

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<sup>196</sup> SEZs for South Africa, Claude Baissac, A report commissioned by the Centre for Development Enterprise, February 2010 page 71 . [http://issuu.com/claudebaissac/docs/sezs\\_for\\_south\\_africa\\_-\\_2010](http://issuu.com/claudebaissac/docs/sezs_for_south_africa_-_2010)

<sup>197</sup> CDE (n122 above).

<sup>198</sup> CDE (n122 above).

<sup>199</sup> CDE (n122 above).

#### **4.3.4 Public versus private sector involvement**

On the one hand, global trends indicate that countries are moving towards greater private sector involvement in owning, operating, and promoting SEZs.<sup>200</sup> South Africa's IDZs on the other hand are exclusively government-owned, promoted and financed; moreover, their management and service delivery is done by firms and a zone operator that are owned by provincial and local governments.<sup>201</sup> The move towards greater private sector involvement in all the levels of SEZ formation, other than law-making, has been spurred by the realisation that in some respects, the private sector may have more expertise and business connections, further, their profit interest can encourage better management and operation of SEZs in South Africa.

#### **4.4 IDZs and international best practice**

Similarly to the DRC, an analysis of the South African IDZ reveals that the challenge that the regime faced related to the failure to apply international best practice. Research conducted by the Centre for Development and Enterprise (CDE) identifies the following nine key issues with the South African IDZ system:

##### **4.4.1 SEZs must be special**

IDZs failed to provide incentives which were unique to them. Successful SEZs offer investors something significantly different from what is available in the rest of the economy, without which an industrial park or zone does not qualify as an SEZ. The exact incentives which are offered and how they differ from the broader structure are dependent on the objectives of the zone, and will differ from zone to zone.<sup>202</sup> Where the aim of a zone, such as the South African IDZs, is geared towards the attraction of FDI, the unique legal and regulatory system should be designed to attract such investment.

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<sup>200</sup> CDE (n122 above) 3.

<sup>201</sup> CDE (n122 above) 3.

<sup>202</sup> CDE (n122 above) 3.



#### **4.4.2 Global competitiveness is what counts**

Notably, investors, in particular foreign investors, choose SEZs for different reasons including one or more of the following; location, market access and logistics; wage levels and labour market practices; access to skilled labour or a favourable legal and regulatory environment.<sup>203</sup> Tax incentives in most zones have received more attention than other incentives. However evidence shows that few investment decisions are made on the basis of these incentives alone and they may also help to attract first movers who may be uncertain of the area's competitiveness.<sup>204</sup> Nonetheless, tax incentives are important but the tax burden in an SEZ should not be out of line with the tax rates paid in the investor's home country or other potential investment locations.<sup>205</sup> The South African IDZ system was not globally competitive as it did not create a locational advantage

#### **4.4.3 SEZs should address challenges faced by local businesses**

SEZs can be utilised as tools to address challenges in the broader economy, such unemployment or underdeveloped industries. SEZs can tailor their offerings to specific sectors and subsectors across the industrial spectrum, which will determine what model of SEZ is created and the specific incentives offered.<sup>206</sup> As such, SEZs should strive towards addressing whatever constraints limit the growth of specific sectors or sub-sectors in the greater economy.<sup>207</sup> The South African IDZs were aimed to attract investment and create jobs but were not implemented in the most effective manner to achieve these objectives.

#### **4.4.4 The costs and flexibility of employment matter**

The question of relaxed labour laws and standards, especially in EPZs or other SEZs that rely on labour-intensive manufacture, is a contentious one as there should be a balance between the desire to attract FDI and the protection of rights of workers. When drawing this balance, it

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<sup>203</sup> CDE (n122 above) 3.

<sup>204</sup> CDE (n122 above) 3.

<sup>205</sup> CDE (n122 above) 3.

<sup>206</sup> CDE (n122 above) 3.

<sup>207</sup> CDE (n122 above) 3.

should be pointed out that overly rigid legal conditions relating to overtime, temporary employment and/or piece-work, shift systems and rules of dismissal can negatively affect labour-intensive industries in SEZs.<sup>208</sup> On one hand, there should at least be a minimum standard achieved with respect to labour matters, but on the other hand best practice demonstrates that the ability to adjust the size of a workforce and their shift systems is an essential determinant a zone's competitiveness.<sup>209</sup> The South African IDZ regime did not provide for much deviation from the present labour regime. This is somewhat controversial considering the countries strong trade union culture.

#### **4.4.5 The most successful SEZs are public-private partnerships**

As has been previously indicated, the exclusive financing, development, regulated and management of IDZs by South African government is among the factors which lead to their poor performance. The institutional approach favoured by international best practice is one where there is a division of participation between the public and private sectors. Accordingly, the role of the government limited to the formulation of policy, law making and enforcement, as well as the provision of essential public goods.<sup>210</sup> On the other hand, due to profit incentive, business networks and contacts with potential tenants, and experience in development and construction, the private sector is better placed to “develop and operate SEZs, including undertaking the master planning, investing in core real estate and services, undertaking construction, managing the zones, and promoting investment”.<sup>211</sup> IDZs failed to properly incorporate the private sector in the development or management despite the initial intention to promote private sector involvement.

#### **4.4.6 SEZs require effective investment promotion agencies**

Finally, international best practice shows that investment promotion agencies should be established and act as a ‘one-stop shop’ as they should ideally be endowed with the authority

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<sup>208</sup> CDE (n 118 above) 3.

<sup>209</sup> CDE (n 118 above) 4.

<sup>210</sup> CDE (n 118 above) 4.

<sup>211</sup> CDE (n 118 above) 4.

to provide authoritative commitments across a wide range of regulatory and licensing requirements.<sup>212</sup> Their primary role should be to actively seek to attract FDI, and not to merely act as investment prevention agencies which screen investment by imposing informal performance requirements as a condition of entry into the host country.<sup>213</sup> The reality though is that most investment promotion agencies have become involved in turf battles with various government departments.<sup>214</sup> The IDZ system lacked an effective investment promotion agency.

#### 4.5 Will the draft SEZ Bill get it right?

Due to the challenges with the present IDZ system, the South African government developing a new SEZ regime thought the enactment of a new SEZ law. The proposed new law is still a draft. The SEZ Bill sets out the general regime for SEZs; It specifically deals with the purpose, policy, strategy, designation, financing and support measures, establishment of SEZs, the creation of an advisory board and an the SEZ operator. On the face of it, the SEZ Bill does indeed seem to create a greater sense of certainty and somewhat deals with some of the challenges discussed in this chapter.<sup>215</sup> However some pertinent issues have not as yet been resolved at this stage and like the draft SEZ regime in the DRC, the devil is in the detail.

The greatest concerns with the new SEZ regime remains fiscal incentives as provided in the country's Tax Act. The first concern relates to the 10-year time period which companies in the SEZ can benefit from tax advantages (2013 – 2023).<sup>216</sup> The basis of this concern it that “most large-scale projects take years to plan and establish and by the time an enterprise is generating enough revenue to make a tax benefit worthwhile, the timeframe may have or would soon lapse.<sup>217</sup> Among the suggested measures to resolve this is to alternatively provide a rolling 10 years from the approval of an incentive.<sup>218</sup> As such there is a need to reevaluate the provisions of the Tax Act dealing with SEZ tax incentives. Secondly, there is criticism over “the exclusive

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<sup>212</sup> CDE (n 118 above) 4.

<sup>213</sup> CDE (n 118 above) 4.

<sup>214</sup> CDE (n 118 above) 4.

<sup>215</sup> SEZ Bill, [http://jutralaw.co.za/media/filestore/2013/09/B3B\\_2013.pdf](http://jutralaw.co.za/media/filestore/2013/09/B3B_2013.pdf)

<sup>216</sup> Duane Newman ‘A few tweaks, and special economic zones will thrive’ (2014)

<http://www.bdlive.co.za/opinion/2014/02/20/a-few-tweaks-and-special-economic-zones-will-thrive>

<sup>217</sup> Duane Newman (n 215 above).

<sup>218</sup> Duane Newman (n 215 above).

reliance on tax incentives, as opposed to an incentive mix involving direct grants for small and medium-sized companies”.<sup>219</sup> In this regard, lower taxes are valuable to an enterprise that are operational, they play a lesser role to set-up companies which are yet to incur a tax liability.<sup>220</sup> Further, the SEZ Bill has not been found to adequately deal with issues surrounding the “difficult operational environment” in South Africa, which includes a volatile currency, a deteriorating labour relations framework and high unit labour costs, and skyrocketing electricity prices.<sup>221</sup> Finally, the draft SEZ legislation does not adequately provide for the role that the private sector will play; the lack thereof greatly hindered the IDZS and deviates from international best practice. Despite these and other remaining issues to be ironed out by the new regime, it is a great first step towards a new SEZ framework for South Africa.

#### 4.6 Conclusion

This chapter examined the South African SEZ legislative framework. South Africa, as has been mentioned, is ideal for the case study because it is an African country which has had experience with SEZs and is in the process of reforming its legislative system. There is currently a strong bond between South Africa and the DRC with respect of SEZ development as the countries have undertaken to assist each other. Although the South African and DRC experience are not completely identical, both countries seem to have faced similar challenges. In this regard, the first lesson that can be drawn from the South African experience is that there should be a comprehensive overarching SEZ regulatory framework that adequately provides of the roles, functions and powers of all the parties involved, as well as clearly sets out the policies that govern an SEZ.

Secondly, an SEZ framework should create some sort of special incentive system, which should also be easily administered. The question of tax incentives is still a contentious one as the role of fiscal incentives in SEZs remains crucial. There should be a balance between fiscal and non-fiscal incentives, as such factors like infrastructure, streamlined administrative procedures and relaxed labour laws can be used to incentivise investors. From the South African perspective,

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<sup>219</sup> Duane Newman (n 215 above).

<sup>220</sup> Duane Newman (n 215 above).

<sup>221</sup> Duane Newman (n 215 above).

it has been found that after much criticism on the failed IDZs, the SEZ Bill may offer a solution. It is a great first step to rectifying some of the challenges faced under the IDZ system. In this regard, the chapter specifically discussed that the current shortcomings of the current system (comprising the SEZ Bill and provisions of the Tax Act which relate to SEZ tax incentives) mostly revolve around the efficacy of the tax incentive, non-fiscal incentives, measures to adequately ease doing business and streamlining the role of the private sector. The DRC should indeed take the opportunity to learn from the South African experience and through the mutual co-operation which both countries have undertaken, lessons can be learnt on both sides.

## CHAPTER 5

### CONCLUSION AND RECOMMENDATIONS

The study has revealed that the rationale behind the establishment of SEZs is to attract investment by improving the business environment.<sup>222</sup> It has been further demonstrated that SEZs should attract FDI by affording investors a combination of advantages that are unique to an SEZ. The efficient use of SEZs by the DRC has been the basis of this study. As has been indicated, if SEZs are properly implemented, they will not only attract FDI and create a more conducive business environment, but will assist the country to tackle some of the war-related challenges that it faces. SEZs in the context of the DRC are more than an economic and legal tool, but a developmental tool in all respects. In assessing whether the country will be able to effectively harness the benefits that SEZs may offer, four main questions were asked:

- i) What is the nature of SEZs in theory and practice?
- ii) What is the existing legislative framework of the DRC and is it in line with international best practices regarding SEZs?
- iii) What has been the South African experience with SEZs?
- iv) What lessons can the DRC learn from the South Africa experience?

The study of SEZs in the DRC is not only timely but pertinent. These research questions were not only formulated and answered with the primary goal of shedding light on and raising issues concerning this crucial part of the DRCs economic and legal framework, but to also contribute to the almost non-existent literature on SEZs in the DRC.

#### 5.1 Summary of findings

The primary chapter of this study provided a brief synopsis of the investment climate in the DRC and presented an outline of the introductory considerations of this study. It uncovered divergent view with respect to the use of SEZs as a policy tool. Nonetheless, the author has

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<sup>222</sup> C Baissac *Special economic zones for South Africa: Lessons from experience*  
<http://www.agbiz.co.za/LinkClick.aspx?fileticket=sNrsFU61htM%3D&tabid=357> (accessed on 22 November 2013)

aligned herself with the view that SEZs in the context of the DRC should not be quickly dismissed. As a result of the forgoing, the second chapter of the study examined the nature of SEZs from a conceptual and practical perspective. The second chapter found that where international best practice is duly taken into account, there is greater probability of success. The role and effect of standards and obligations of international organisations has also been revealed. This set the basis for chapter three, which evaluated SEZs within the context of the DRC.

Various challenges were raised in examining the current national legislative and regulatory system of the DRC. These are tied down to two key issues which are (1) the lack of a “special” system and (2) uncertainty. The lack of a “special” system re-emerged as a somewhat unresolved challenge under the proposed new SEZ legislative regime although the system somewhat creates more certainty. A similar challenge has necessitate the transition to a new SEZ regime in South Africa. The key shortcomings identified in the study of South Africa, also emanated from the failure consider international best practice and the DRC can indeed draw lessons from the experience.

## **5.2 Recommendations**

In light of the above this study recommends that the formulation of new SEZ legislation should take cognisance of the need for:

- i) A fiscal incentive regime that will be unique to SEZs, while not being the sole type of incentive offered to them;
- ii) Further clarity on institutional and regulatory issues including the role of the private sector and the implementation of non-fiscal incentives, either by elaborating in the main SEZ legislation or by creating implementing legislation.

## **5.3 Final Conclusion**

The DRC can hone its potential through the effective use of SEZs, however there is still some need to improve the legislative framework that governs them. The country has previously grappled with free industrial zones, however the challenges are not insurmountable. What is required is that the policy, institutional, incentive and regulatory framework are key components which should be brought in alignment with international best practice. Should the

DRC effectively implement SEZs the benefits will be great as the country needs both industrial reform as well as post war reconstruction.

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