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Special Missing Zones in South Africa's Policy on Special Economic Zones

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Introduction

In November 2011, the South African Cabinet approved Special Missing Zones in South Africa's Policy on Special Economic Zones to be published for public participation, and in January 2012, the Minister of Trade and Industry issued the Special Economic Zones Policy and Bill inviting interested parties to submit public comment within 60 days of its publication.

The introduction of this bill certainly evoked a lot of public comment; and probably the most comprehensive discussion of this policy is to be found in the edited proceedings of a Round Table conference hosted by the Centre for Development and Enterprise (CDE, 2011) dealing with the issue of 'Lessons for South Africa from International Evidence and Local Experience' (CDE, 2011).

An excellent and concise summary of this Round Table event was published by Sean Woolfrey in a tralac note 'South Africa's proposed Special Economic Zone Policy' on 6 June 2012 (Woolfrey, 2012). The Executive Summary in the CDE document highlights many of the issues to be considered in the implementation of this new policy and, to its credit, the summary consistently highlights several priorities in implementation as to whether or not these can be successful in a South African context. These are based not only on international experience with zonal economic development, but also highlight South Africa's disappointing experiences with the previous Industrial Development Zone (IDZ) policy established since 2000, that explicitly attempted to promote value-added exports and export-oriented industries, establish spatial development corridors and attract domestic and foreign investment into the country. Since its inception, the criterion for the selection of the various IDZs in South Africa has related to their proximity to international airports and seaports.

The new bill sets out the objectives and key provisions of the modified SEZ policy. As far as the objectives are concerned, these will be elaborated on later. The key provisions of the bill provide, *inter alia*, for the establishment of an SEZ Board composed of representatives of key government departments, state agencies and independent experts to advise the minister on policy, strategy and other matters. Additionally, there is provision for the establishment of a SEZ Fund to provide for sustainable long-term financing (with an ongoing adaptation of incentives in line with development needs) and a clause providing for increased diversity of SEZs to cater for different regional development needs and contexts.

Since the publication of the draft bill, there has been much comment on the advantages and disadvantages of the new SEZ policy and process in the country, of which the CDE Roundtable added an important dimension. Given the renewed emphasis in economic policy debates on industrial policy and regional integration in the wider Southern Africa context, this note serves to add to the debate by introducing some hitherto neglected aspects pertinent to the debate on the SEZ policy in South Africa.

The shifting focus of SEZs

The 2012 Department of Trade and Industry (DTI) presentation of the bill adopts as its framework the least complex definition of a Special Economic Zone. It refers to SEZs as ' geographical designated areas of a country set aside for specifically targeted economic activities which are then supported through special arrangements (which may include laws) and support systems that are different from those that apply in the rest of the country' (Government Gazette, Notice 45 of DTI, 2012a).

The explicit objectives of introducing a new SEZ policy in South Africa according to the DTI proposal include supporting the development of targeted industrial capabilities and attraction of FDI within the Industrial Policy Action Plan as well as the New Growth Path framework. In addition, there is reference to the development of a world class infrastructure 'in line with the targeted industries in each region'. Besides, the DTI presentation adds objectives such as the establishment of the promotion and value addition of the country's minerals as well as the acceleration of economic growth and job creation (DTI, 2011).

The establishment of SEZs is not a new phenomenon. In fact, literature documents these going as far back as some 50 years and estimates by the International Labour Organisation database on SEZs list some specific 3 500 zones in 130 countries existing by 2006 (Farole, VOX,2011). Until recently, most of these were predominantly traditional Export Processing Zones (EPZs), designed essentially to attract investment by enabling countries to better utilise their supposed key source of comparative advantage – low labour costs – in an endeavour to overcome barriers reinforcing low levels of both domestic and foreign investment in potential export expansion. These barriers included *inter alia* an inhibiting regulatory and infrastructural environment.

The thrust of earlier EPZ policy was therefore focused on allowing investors to import and export goods and services, free of duties and exchange controls as well as on easing the licensing and regulatory processes for conducting such business. In many cases, tax (corporate as well as VAT) obligations were substantially relaxed for investors. To control these establishments, EPZs were confined to 'fenced-in' estates with strict customs control at entry and sales were restricted mainly to export markets (Farole, VOX, 2011).

The success of this set of policies has been acknowledged in many countries, for example in East Asia, and even countries such as Mauritius and Madagascar. However, the extent to which these measures accounted for the successes in these countries is a matter open to debate. What has to be realised is that such progress in industrialisation and job creation in these countries took part in an era of unprecedented globalisation of trade and investment from the 1970s to the earlier years of the new millennium.

Additionally, Farole (VOX, 2011) makes the point that incentives played only a modest part in this success story and that the provision of infrastructure in the form of services, reliable power and a sustainable global basis infrastructural supply greatly contributed to the success of these particular SEZs.

Given the dramatically altered world macroeconomic and regulatory environment over the past six years or so, it is clear that the traditional EPZ model has become limited, and that the introduction of a much more widespread SEZ regime that incorporates more than a specific focus on exports, is being considered in various countries. However, as Farole (2011) warns, 'it is not the existence of a special-economic-zone regime, a compelling master plan or fully-built-out infrastructure that will make the difference in attracting investment, creating jobs and generating spillovers to the local economy. Rather it is the relevance of the special-economic-zone programmes in the specific context in which they are introduced and the effectiveness with which they are designed, implemented and managed on an ongoing basis that will determine the success or failure'." (Farole, 2011, op. cit.).

It is interesting to note that, while, conceptually at least, the nature of a 'special economic zone' in recent times has tended to evolve continuously to reflect new forms of zones and to cater for previous ones that are no longer functional, there are certain structural features of a zone that are 'sufficiently precise to exclude those that do not display the essential features that make a zone, a zone' (Baissac, 2011: 24). These include the fact that they are 'primarily formally delimited portions of a national territory and secondarily legal spaces provided with a set of investment, trade and operating rules that are more liberal and administratively efficient than those prevailing in the rest of the national territory' (Ibid.). Therefore zones incorporate a specific regulatory regime to assure differentiation.

Further, there is a prerequisite of a centralised (or decentralised) 'dedicated governance structure' so as to ensure efficient management of the regime and ensure that investors benefit from the provisions of the policy. This can take the form of public and/or private governance and would vary according to the nature of the zone regime.

A final structural feature identified by Baissac (2011) relates to the provision of physical infrastructure in the demarcated zones to support the activities of firms and economic agents operating in these zones. Baissac (Ibid.) includes real estate, electricity, water and communications amongst these and identifies such infrastructure as usually being composed of industrial or mixed usage activity parks and key transport facilities so as to connect the zone to its sources, markets and economic hinterland.

While, to varying extents, the above are categorised in the literature as necessary structural attributes of special economic zones, Baissac (2011) does make the point that not all types of zones display all these attributes at once, although 'prototypical' types such as export processing zones tend to include all of them. According to his argument the essential determining structural feature is that it benefits from a different regulatory regime from that in the rest of the country.

In the presentation of the draft Special Economic Zones Policy and Bill for South Africa, provision is made for the establishment of a separate regulatory framework comprising a SEZ Board to advise the minister on policy, strategy and other matters, and its composition includes representatives of key government departments, state agencies and independent experts. Additionally, there is provision for the establishment of a SEZ Fund to provide predictable long-term finance and an ongoing adaptation of incentives in line with strategic development needs. The bill also provides for a range of diverse SEZs to cater for diverse regional development needs and contexts. Reference is also made in terms of the bill's legislative thrust to the involvement of the three tiers of government although there is accommodation for public and private partnership in the application to the specific zones.

Thus, while the introduction of the SEZ Bill and Policy does meet the criteria of a separate and dedicated regulatory authority and, in line with the trend in several countries, reflects a far more general approach to the rationale for the establishment of these zones in the light of the prevailing systemic crisis in the world economy, overall success of these zones will not be solely determined by the establishment of these zones, but rather by broader economic growth fundamentals in the economy in question.

The policy rationale for Special Economic Zones and its South African context

As with many forms of state intervention, there is a legitimate case for such policies if the criteria for such success are based on social rates of return far outweigh the social costs of implementing these policies. According to Baissac (2011), 'zones are created to generate or participate in the economic transformation of their host countries in a way that is faster and more effective than would be the case without them. They are developed to act as catalysts for growth'.(Baissac 2011) This author then relates to the specific Foreign Investment Advisory Service (FIAS) report identifying four specific policy goals (in their opinion not necessarily exclusive) underlying much of the more recent zone creation:

- to attract foreign direct investment
- to serve as 'pressure valves' to alleviate large-scale unemployment
- to support a wider-scale economic reform strategy , particularly pertaining to exports and anti-export bias
- to serve as experimental laboratories for the application of new policies and approaches relying on policy changes within economic zones to be extended over time to the rest of the economy.

As far as South Africa's SEZ Policy and Bill are concerned, the overriding objective relates to the first two policy goals referred to above. The Department of Trade and Industry explicitly specifies the objectives of the new bill as:

- supporting the acceleration of industrial development in order to promote growth and the creation of sustainable and decent jobs
- and to promote the creation of a regionally diverse economy through the development of new industrial hubs in underdeveloped regions within the framework of Industrial Policy Action Plan (IPAP) and the New Growth Plan.

Additionally the objectives specify the development of world-class infrastructure in line with the targeted industries in each region and the promotion of beneficiation and value addition of the country's minerals.

These objectives are argued to be justified by virtue of their possibility of contributing to the acceleration of economic growth and job creation in the country. What is an interesting omission in the presentation of the draft bill and discussion of policy relates to the neglect of the issues of widespread economic reform and extension of these policies to the rest of the economy in order for these to be sustainable over time. Does this in fact imply that the administration of the policy will be primarily targeted to subsidise selected industries identified in South Africa's IPAP and the New Growth Strategy or be accommodating to other industries in order for these to develop either a comparative or competitive advantage?

Furthermore, the selection of geographical areas for establishing these SEZs is also vague and can lead to contention. If such areas are going to be determined predominantly by narrow political considerations rather than by more dynamic economic considerations, the policy will be a drain on resources. While the draft bill initially refers only to converting those areas presently designated as IDZ areas into SEZs, much of the thrust of future policy will have to address the issue of how to create a regionally diverse and balanced economy.

Related to the above, in terms of the draft bill's vagueness in presentation, is the lack of the definition of a region. Do the envisaged spatial 'zones' incorporate only a narrow national perspective or a much wider Special Economic Zone incorporating a broader region? Given the growing importance and sensitivities of a range of regional trade arrangements and regional integration initiatives in Southern Africa (Southern African Customs Union, Southern African Development Community, Tripartite FTA, etc.) , it should be emphasised that the incorporation of the broader region in the framework could offer significant opportunities not only for enhancing the success of special economic zones in a South African context, but also for presenting an opportunity for incorporating several of our regional trade partners at various levels into a more harmonious and truly integrated set of economic policies than is presently the case.

There are numerous ways in which incorporating a more integrative framework can facilitate the success of SEZs. As levels of committed trade liberalisation within various regional enclaves increases, attention will have to be paid to looking beyond the narrow borders that necessitate the incorporation of ' integrated or at least harmonized approaches to SEZ legal and regulatory frameworks, particularly on the treatment of exports, rules of origin and fiscal incentives' (Farole, PREM Economic Premise, September 2011). For small countries locked into regional trade initiatives, there could also be considerable potential for using economic zones to link into regional supply chains, exploiting backward and forward linkages and bringing about agglomeration and scale economies in production, almost certainly creating the potential for competitive wider industrial clusters in the region (Dobrovnogov and Farole, 2012). Thus the SEZ benefits could well extend beyond the core.

Furthermore, SEZs can offer sector-specific public goods such as warehousing and logistics platforms, design and shared processing facilities that can induce and encourage the creation of broader industrial clusters in the region. Potential advantages exist that would encourage increased foreign and local investment – provided that the notion of the region is properly identified and a more extensive approach to the potential dynamic and widespread benefits is taken into cognisance. In the presentation of the draft SEZ Policy and Bill there is no specific reference to the broader region either encompassing Botswana, Lesotho, Namibia and Swaziland (the BLNS countries) or even SADC. In the light of future developments regarding a broader regional Southern African Industrial Policy – not to mention the prospect of future TFTA arrangement – it is disappointing, to say the least, that there is very little focus or even acknowledgement of the potential for SEZs in South Africa to interact with neighbouring states and other regional partners in this endeavour. Additionally the proposed establishment of the SEZ Board makes no allowance for representation from this critically important constituency.

The various issues and comments raised above are designed to encourage increased debate and a future research agenda on the issue of SEZs in South Africa. There certainly is potential for these policies to be successful and sustainable, even in the present global environment. The key question is whether the envisaged policy is implemented in a manner that goes beyond only catering for narrow and sectional political interests. The incorporation of a wider concept of the region extending beyond South Africa's national borders offers an ideal opportunity for enhancing the successes of such a policy.

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