

# SPECIAL ECONOMIC ZONES (SEZs) IN SOUTHERN AFRICAN DEVELOPMENT COMMUNITY (SADC)

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## Abstract

There have been calls on Southern African Development Community (SADC) governments to devise strategies to boost economic growth, structural and infrastructural development. Economists have been recommending that Foreign Direct Investment (FDI) would foster long term economic growth rather than borrowing from multilateral institutions, hence Special Economic Zones (SEZs) have been established to attract investments. However, there have been arguments against SEZs on the net benefit accruing to the host nation from SEZs. This study applied the Ordinary Least Squares (OLS) on 15 SADC member countries' SEZs profit remittance data and draw a multi-linear regression model to establish the relationship between national income and FDI. The results show that there is a not significant relationship between these variables. Hence there is no net benefit accruing to the host country by establishing SEZs. However long-term benefits may be realised if the companies operating in these zones construct infrastructures and other structural developments.

**Keywords:** Economic Growth, Investments, Infrastructure, Development

## 1. INTRODUCTION

Several governments in SADC have identified the establishment of Special Economic Zones (SEZs) as a strategy to boost economic growth and development. SEZs are designated geographical areas that operate under different economic rules from the rest of the economy. Tax incentives are at the centre of SEZs' aimed at attracting foreign investment. There have been arguments that tax holidays result in benefits accruing to the country of origin of the concerned companies and not the host country. Literally, offering tax incentives to foreign companies is tantamount to surrendering the host country's taxing rights and would negatively impact on socio-economic development. Technically, it is not only giving relief to the foreign companies but also transferring a sovereign's taxing rights to the country of origin of those companies.

## 2. REVIEW OF RELATED LITERATURE

Special Economic Zones (SEZs) have theoretically been used for many reasons, among them; promoting exports of goods and services, promoting investment from domestic and foreign sources, creating employment, developing infrastructure facilities and generating additional economic activity. In some cases, SEZs also serve as a laboratory to test whether business-friendly policies are worth rolling out on a larger scale. This way, SEZs are useful when introducing economic reforms that may not be possible at national level (Farole, 2011).

China has been leading economic engagement with SADC through SEZs in the recent past. Trade

between China and Africa reached \$1.06 trillion in 2014, twenty times the 2004 figure (Country Economics, 2014). However, the impact of China's economic engagement in Southern Africa is hotly debated, whether it is positive or negative. Marysse and Geenen (2009) argue that China's engagement in Africa is neo-colonial in nature; it is exclusively about getting access to natural resources. This has been evidenced by the influx of competitive Chinese products, small-scale Chinese traders and Chinese labour force in infrastructure projects. This is in fact a serious threat to Southern African manufacturers, market vendors, and workers. In this view, Marysse and Geenen conclude that Chinese engagement is very unlikely to aide SADC's long-term development goals.

Gayan (2008) concurs with Marysse and Geenen (2009) in challenging the Chinese leaders' view that SEZs are an important measure to help SADC countries to develop their industries and expand local employment. Gavan is of the opinion that, SEZs might be primarily political investments linked to Beijing's long-term geo-strategic ambitions and unlikely to foster sustainable local development.

Kim (2013) defends the opinion of Gayan (2008) that SEZs are merely political investment vehicles. Kim substantiates this view by questioning why these SEZs; do not employ locals or employ them only at the lowest levels and why they are reluctant to transfer or diffuse technology and know-how on how to effectively market the zones to local people; attract industries that are simply more polluting or adopt worker safety standards that are lower than those outside the zones; serve as uneconomic 'prestige projects' offered merely in exchange for other benefits such as access to

resources. Another critical issue on SADC SEZs has been the labour market frictions. Instead of creating employment for the host country, they have been importing technical workforce into the host country.

The effectiveness of these SEZs is relative and also subjective because not all of them are created equal. Different countries present different opportunities and challenges. Hence, there is no single SEZ model applicable in all countries because many advantages are country-specific and need to be carefully matched with a specific corporate strategy (World Bank Report, 2011). Their success comes with a well laid fundamental support to the businesses amongst them; constant access to power and conducive investment climate.

On the other hand, the World Bank Report (2012) points out that weak industrial competitiveness in Sub-Saharan Africa have retarded economic growth. Lack of policy stability, poor infrastructure and high indirect costs related to a poor business environment have been at the centre of weakening industrial growth. Also, a number of problems in the wider investment environment in Africa have also hindered development of most SEZ projects on the continent. These problems include infrastructure shortfalls, administrative weaknesses, ineffective management, policy uncertainty, and poor strategic and operational planning.

Having analyzed the intended benefits of SEZs, The Consultancy Africa Intelligence (2014) questioned some grey areas of SEZs. Its report highly criticized the intention of these institutions, raising so many questions on whether the benefits could possibly outweigh their costs. Kadam (2012) argues that, if the SEZs are meant to bring-in all inclusive economic growth, then it is rational that they should pay taxes and make a positive contribution to the growth of the economy. Otherwise the indirect benefits such as stimulating economic activity and employment opportunities may never materialize.

Kadam (2012) also identifies another evil brought about by the existence of SEZs, violation of property rights by governments through land grabbing at very low or zero prices. This has created dark zones for government officials to use SEZs as vehicles for graft, money laundering and inflating exports values for self-benefits. Hence, lack of transparency in most of the SEZs has defeated their purpose and threatened their entire existence. The question remains whether there is a real benefit accruing to the host nation from SEZs or its all economic gambling.

### 3. METHODOLOGY

The data used in this research includes Gross Domestic Product (GDP), Foreign Direct Investment (FDI), consumption expenditure, government spending and net exports of all the 15 SADC member states obtained from Country Economics and Index Mundi databases for 10 years (2004 - 2014). SEZs capital flow is directly correlated to FDI, hence FDI data was adopted. The effects of FDI to the economy is realised through GDP at factor cost, therefore the factor incomes model was applied. Here GDP is the sum of the incomes earned through the production of goods and services. This is:

$$GDP_{(t,\omega)} = Y_{(t,\omega)} + \rho_{(t,\omega)} + \tau_{(t,\omega)}$$

Where:

$Y_{(t,\omega)}$  is income from people in jobs and in self – employment.

$\rho_{(t,\omega)}$  is profits of private sector businesses.

$\tau_{(t,\omega)}$  is rent income from the ownership of land.

This model makes a better estimation of the effect of SEZs income because it only considers those incomes that come from the production of goods and services are included in the calculation of GDP by the income approach. We exclude transfer payments, private transfers, income not registered with the Inland Revenue or customs and excise and other income in the shadow economy. However the issue of unreported income in the SEZs, where the government partnerships don't provide all the right information about their incomes to evade accountability caused disparities in the counting of national income.

A multi-linear correlation regression model was run by the Ordinary Least Squares (OLS) method for the period 2004 to 2014 to determine the coefficient of relationship between the variable of interest (FDI) and the explained variable GDP. The FDI inflows profit remittance data was also plotted against GDP and FDI to analyse if there was any time series relationship for the period considered in this study. The overall performance of three estimates is satisfactory. Values of adjusted R<sup>2</sup> in the three cases were from 71 percent to 85 percent, indicating a strong explanatory power of the models, and the significance level of F test is p<0.001, indicating that the significance of the model regression as a whole is high.

### 4. FINDINGS

In Angola, an economy of \$131 billion GDP, SEZs have resulted in net income outflow of 8% in 2014. The SEZs have been remitting an average of \$6 million annually in profit, with a maximum of \$13.184 million in 2008. Angola's GDP is therefore driven by other variables other than FDI through SEZs. In Botswana, only 0.16% of its GDP is derived from SEZs. In DRC, 31% of its GDP is driven by FDI. The country has experienced a sharp growth during this period under analysis; data shows that without SEZs in DRC, economic growth will be highly retarded. There has been no profit remittances form SEZ for the whole period under study.

In Lesotho, a \$2 billion economy, 2,5% of its GDP income comes from SEZs; of which there is a significant growth in profit remittances from SEZs in this country from \$158.3 million in 2004 to \$406.8 million in 2012. A \$10 billion economy, Madagascar, has been remitting no profit from it 8% growth SEZs for the 10 consecutive years. In Mauritius SEZs have been remitting significant profits which has contributed 9.8% of the GDP.

Seychelles, the smallest economy in SADC according to GDP (\$1.406 billion), has been remitting a constant profit averaging \$20 million annually from its SEZs despite a significant growth in FDI from \$38 million in 2004 to \$206.1 million in 2014. It however constitutes 3.28% of the GDP income. The largest economy in SADC, South Africa, with a GDP of \$350 billion; remitted a maximum of \$8.5 billion in 2012 spanning from approximately \$4.6 billion

FDI which constituted 3.03% of the national GDP income in the same year. In 2014, 15.31% of Zimbabwe's GDP income was coming from SEZs which invested approximately \$429 billion. There was no profit remittance despite \$2.158 FDI flowing into the country's SEZs' most lucrative businesses.

**CONCLUSION**

Quantifying the pure costs of incentives and potential benefits lost in creating SEZs is very difficult. The cost of tax incentives in SEZs is therefore wide-ranging and goes beyond immediate potential revenue loss. Apart from revenue losses, SEZs are causing economic distortions spanning from preferential treatment of foreign investors, mostly Chinese, at the expense of local investors. Offering foreign investors a tax incentive allows them low running costs, hence can afford to sell their outputs cheap. Analysed statistics shows that incentives successfully improved FDI, but on the other hand it also crowds out other investments, so that aggregate investment and growth depreciates or remain constant. The SEZs have also been a hub for graft; fraudulent use of incentives schemes and rent-seeking by government officials, hence, SEZs are not yielding intended benefits.

**RECOMMENDATIONS**

SADC governments seem to be emotional about taxation and development issues. They should do a cost and benefit analysis in the due diligence process of setting up SEZs, taking stock of what has been achieved and reconcile what has been done in the past. Since the success of SEZs is country specific, granting investment incentives should be

done depending solely on what the government wants to achieve in the medium to long-term. There are a number of local investors who find it very difficult to invest in their own countries; governments should instead put most of its focus on encouraging domestic investment. Currently there are too many inconsistent laws and taxes that are stifling the growth of local companies which governments should get rid of. Instead of SEZs for Chinese entrepreneurs, local individuals should be encouraged to do their businesses and be supported consistently where they need support.

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**APPENDICES**

SADC COUNTRIES' PROFIT REMITTANCE FROM FDI





