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SPECIAL ECONOMIC ZONES

Time to bring private sector into SEZs

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In SA, as in many other developing countries, special economic zones (SEZs) are a major feature of industrial policy.

An Inclusive Society Institute report from December 2023 cited economist Neva Makgetla reporting that national government transfers to SEZs amounted to R1.1bn in 2020-21 from R600m in 2013-14, and reached a peak of R1.7bn in 2017-18.

Due to fiscal tightening the current year's department of trade, industry & competition infrastructure budget, from which SEZs are funded, has been slashed by more than R1bn.

SEZs are a flexible policy tool that can be adapted to the circumstances of countries seeking to kick-start industrialisation or promote the upgrading and diversification of industry. They are designed to be a magnet for inward investment, resulting in employment, exports and inward technology transfer.

SA's SEZ programme has yet to stem the steady but sure erosion of the country's industrial capabilities, rising unemployment and falling incomes.

The department's recently launched industrial policy & strategy review document, which was intended to map out and reflect on industrial policy over the past five years, is strangely silent on the causes of this underachievement and fails to suggest possible remedies to the SEZ programme.

SEZ programmes are a high-risk, high-reward game in that they are expensive to implement. They have succeeded in only a minority of countries. Resurgent global interest in industrial policy has spurred increased research on what factors produced the successful zones, and what aspirant countries such as SA can learn from their successful peers.

Where SEZs have been implemented well, as in the East Asian economies of Singapore, South Korea, Taiwan and the People's Republic of China — as well as Mauritius — they have transformed the industrial structures of the countries involved by promoting rapid capital accumulation in industry, innovation, technological upgrading, skills development and integration into global value chains.

In China, whole cities were designated as SEZs as part of the "open-door" policy of the early 1980s. Much of the success in transforming the country by economic reformer Deng Xiaoping had to do with these SEZ policies. China initially limited private sector participation in its economy to SEZs in coastal areas, which offered a liberally regulated environment with rules not applicable to the interior. Those areas worked well, and the model was later rolled out to the rest of the country.

The emphasis in recent research on the adaptation of the SEZ concept to the circumstances of each country and the need for a stable, well-managed regulatory environment within the SEZs, suggests several reforms that could enhance SA's SEZ programme.

The key reform should be increased participation by the private sector in the rollout of the programme, and we also require far closer co-ordination among government departments and agencies responsible for the implementation of the programme.

Despite an emergent global trend of increased private sector participation in the implementation of SEZs, the SA government chose to pursue a model in which SEZs were wholly government-driven and owned when the SEZ programme underwent reform in 2014. Though current SEZ legislation provides a role for the private sector in zone designation, development and operation, the opportunities for such participation are restricted by unrealistic requirements, with the result that little private sector interest has been elicited. There is some limited private sector investment in buildings within the SEZs, but far more could be done.

IMPROVE GOVERNANCE

SA has a mature, well-resourced private sector, and greater participation by the private sector is one way in which the country could more effectively leverage its comparative advantages. Allowing the private sector to develop and manage SEZs would increase the scale of resources available for zone development. It will allow for agile management of zones, as private sector enterprises tend to have far more flexibility than government institutions in how they operate.

SEZs do not operate as businesses and wholly rely on government's budgeting cycle. Funding availability is largely determined by the state of government finances, whereas funding needs are triggered by the availability of profitable market opportunities to locate investors. The participation of the private sector will also improve the governance of the programme by encouraging the separation of the roles of developers and regulators.

There is an inherent conflict of interest when a single state institution acts as regulator, developer and operator of a country's SEZs.

Protecting private-sector SEZ developers would require the establishment of an independent regulatory agency purely focused on regulation, planning and promotion.

SEZs are a long-term game requiring substantial upfront investment, with minimal commercial returns in the initial phases. Private sector developers would therefore require some initial co-investment by government in zone infrastructure provision — or the implementation of customised public-private partnership arrangements.

Regarding the predictability of regulations, SA's SEZ programme leaves a lot to be desired. A case in point is the provision of fiscal incentives, a task that requires co-ordination and consultation between the department, the SA Revenue Service, and the National Treasury.

However, in practice there has been a baffling lack of consistency in the regulation of incentives. Certain, older SEZs have the full array of incentives, most notably a lower rate of corporate tax. The new SEZs don't offer a complete incentive package, and it is difficult to understand why not.

No clear policy framework has been articulated on which of the country's SEZs should, and which ones shouldn't, receive all the incentives. Possibly this is because there is a degree of conflict within the government over the merits and value of the SEZ programme.

Investors interested in establishing factories in SA's SEZs are confused over where to locate, unsure that the SEZ programme will deliver the incentives government says it will deliver. Some of the firms that come to look at potential investments in SA are turned off by this unpredictable regulatory and business environment.

This makes the marketing of the country's SEZs at times misleading, and this can cause friction between the SEZ operational companies and investors. It does not assist SA when potential investors hear complaints that existing investors, already operating in some SEZs, have not received all the incentives that they were promised.

The provision of the full range of SEZ incentives needs to be consistent and not dependent on the whim of government departments. The department of trade, industry & competition website identifies 11 active SEZs, but the reduced tax rates are only available in six of these. Yet all zones are still promoted by the department, and by the SEZs themselves, as if they all offer the full suite of incentives.

If the programme is to succeed government policy needs to be agile. We must learn from other countries and continuously experiment with new approaches while keeping the costs of such experimentation low through continuous assessment — adopting what works and discarding that which does not work.

Industrial policy is never easy and it is even less so in SA, where there is deep-rooted mutual suspicion between the government and the private sector. However, the stakes are high. There needs to be better dialogue, understanding and partnership between government and the private sector if the development of SEZs — and our entire industrial policy — is to reap the desperately needed rewards of more employment, a game-changing growth rate, and a higher level of exports.

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