Reconfiguring Special Economic Zones for Sustainable Development and Inclusive Growth in Africa:

A Theoretical Review

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Abstract

For decades, special economic zones (SEZs) have been popularly used as an industrial policy strategy to drive economic growth and development. They are a tool to facilitate the creation of industrial complexes that have a strategic national economic advantage for targeted investments and industries in the manufacturing sector and tradable industries. Several benefits from SEZ development have been identified; however, the success and benefits of SEZs vary by country and region. While SEZs focus on stimulating industrial development, charter cities focus on residential and industrial development in a new model. This paper explores the literature to identify factors behind the failure of the SEZ model in Africa and explores the charter cities model as an alternative. The findings reveal that a weak institutional and regulatory framework, lack of coordination among stakeholders, SEZ design, poor alignment of SEZ policy to national policy objectives, and lack of infrastructure investment are the significant challenges that hinder the success of SEZs in Africa. Nevertheless, the charter cities model is suitable for African countries since it stimulates urban planning through coordinated governance which eventually reduces the cost of doing business, thus promoting sustainable growth and development. For instance, proper coordination among ministries responsible for urban planning and economic development and fiscal matters, sectoral ministries and specialized agencies, public-private partnerships, city-level public actors, local urban planning authorities, as well as investment promotion agencies at all spheres of government need to participate as strategic partners in facilitating investments actively.

Keywords: Special economic zones, Africa, Investments, economic growth, charter cities

1. *Introduction*

For decades, special economic zones (SEZs) have been popularly used as an industrial policy strategy to drive economic growth and development, particularly in developed economies. These zones were established as part of innovative industrial policy to enhance investment attractiveness and foster inclusive growth. According to the literature (Aggarwal, 2010; Farole and Moberg, 2014) the rationale behind establishing SEZs as part of spatial development initiatives was to facilitate the creation of industrial complexes that have a strategic national economic advantage for targeted investments and industries in the manufacturing sector and tradable industries. Furthermore, SEZs are intended to develop other infrastructure required to support targeted industrial activities; and, most importantly, to attract domestic and foreign investments while also creating a location for targeted investments and enabling the beneficiation of natural and mineral resources.

Additionally, SEZs have been introduced to take advantage of the existing industrial and technological capacity to promote integration with local industries and increase value-added production. SEZs promote regional development by creating decent work and economic and social benefits in regions where the zone will be located. These benefits include broadening

the participation of small, medium, and micro-enterprises (SMMEs) and cooperatives in the mainstream economy; while generating new innovative economic activities and firm-level investment. Improvement in firm-level productivity occurs through enhancing firm-level coordination networks innovation (UNDP, 2015). Noteworthy, although SEZs have been widely used, the objective behind their use varies by country and the level of development of countries.

For instance, while developed economies have used SEZs as custom-free zones that relax tariffs and the administrative burden of customs procedures to accelerate cross-border supply chains, developing countries have used SEZs to mainly foster foreign direct investment and diversify and advance industries (Farole and Akinci, 2011).

Consequently, the last two decades have seen a proliferation of SEZs in emerging and transition economies. This followed a global belief that SEZs are a mechanism through which industrialization can be accelerated while also stimulating economic development and job creation.

The adoption of SEZs as an industrial policy strategy was inspired by their significant contributions to the Asian economies' progress, particularly that of China. Farole and Moberg (2014) note that the success of SEZs in East Asia was attributable to the commitment of political leaders. In countries such as China and Vietnam, senior government officials and party leadership were committed to driving the success of SEZs through creating an enabling environment for successful implementation (Newman and Page, 2017).

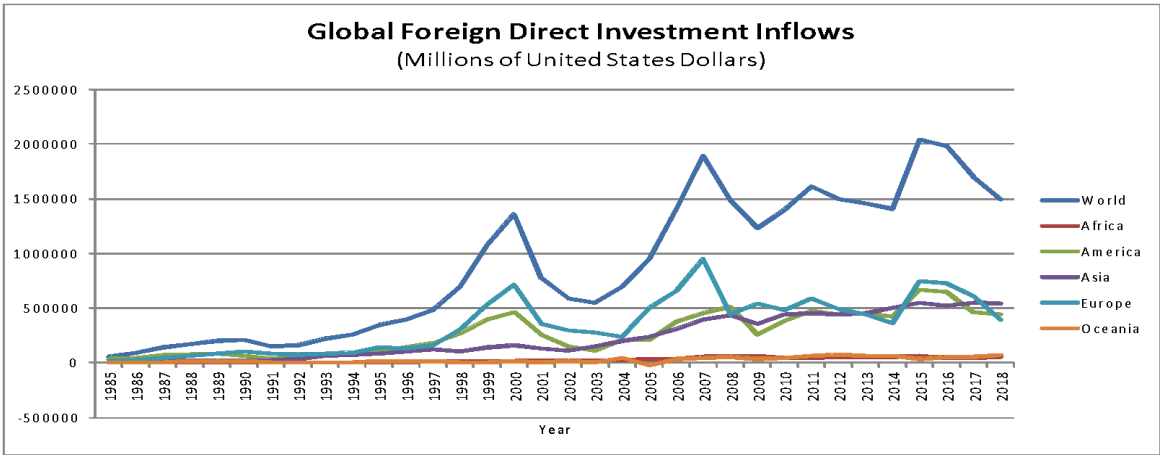
According to Tang (2020), China successfully utilized SEZs for economic transformation – its zones were developed to capitalize on local economic advantages while fostering inclusive economic growth. These include national zones, high tech industrial development zones, free trade zones, and export processing zones at national and regional levels. Data from the World Bank reveals that SEZs in China is estimated to have accounted for 22% of national GDP, 46% of FDI, 60% of exports, and generated over 30 million jobs. In addition, industrial parks account for 80-90% of GDP growth (UNDP, 2015).

However, the African continent adopted the SEZ approach relatively late, however, this zone-development model received considerable traction within the continent. For instance, it is estimated that 237 SEZs and 57 SEZ projects exist in 47 out of 54 countries across the continent (AEZO, 2019). Of the total SEZs in the continent, Eastern Africa accounts for 29 percent of total zones. In contrast, Northern Africa, Western Africa, Southern Africa, and Central Africa account for 28 percent, 19 percent 15 percent, and 8 percent of the total (AEZO, 2019). The number of SEZs established in Africa shows the extent of the significance of creating an investor-friendly environment in the continent.

The primary purpose behind the adoption of SEZs as an industrial strategy in Africa was to attract foreign direct investment, stimulate exports, create jobs, and reduce poverty levels while generating spillover effects to the rest of the economy and fostering linkages with domestic businesses.

Notwithstanding the adoption of SEZs in Africa, the literature reveals that the success in attracting FDI, stimulating exports and generating spillover effects and linkages with local firms has been minimal (Newman and Page, 2017; Farole and Moberg, 2017).

Figure 1: Global foreign direct investment inflows by region (author's compilation)



As shown in Figure 1, the African continent remains unattractive to foreign investments, as it only accounts for less than 3 percent of global FDI. This is insignificant compared to developed countries which account for 49.8 percent, while developing Asia and Latin America accounted for 33.3 percent and 10.6 percent, respectively. Furthermore, the World Investment Report (2019) shows that between 2016 and 2017, Africa experienced a 21 percent decline in its FDI inflows, while Sub-Saharan Africa's FDI inflows dropped by 28 percent, whereas Southern Africa's FDI fell by 66 percent. The unfavourable climate in the continent has eroded the hope of stimulating economic prosperity through FDI, which ultimately addresses all socioeconomic challenges that the continent is grappling with. Of particular concern is rising population rates, skyrocketing unemployment rates and persistent poverty levels, and widening inequality levels.

The rest of the paper is structured as follows: Section 2 discusses SEZs in detail; Section 3 presents best practices in SEZs; Section 4 overviews SEZs in Africa; Section 5 assesses the relative failure of SEZs in Africa; Section 6 considers the charter cities model; and Section 7 concludes.

2. What are Special Economic Zones?

According to Balasubramanyam (1988), Farole and Akinci (2011), and UNDP (2015), SEZs can be defined as development intervention strategies in the form of designated areas where the laws and rules governing that area are different to those that apply to the rest of the country.

They facilitate industrial activity through fiscal and regulatory incentives, and infrastructure support is high (Tang, 2020).

The rules governing these areas deal with investments conditions, international trade and customs, taxation, and the regulatory environment. Theoretically, SEZs come with unique benefits, fiscal and non-fiscal incentives. These include tax holidays, duty-free exports, imports; tax exemptions and reductions; exemption from labour laws; ease of doing business; improved infrastructure and facilities; free repatriation of profits; and preferential geographical location to stimulate operations within the zone (Tang, 2020).

Based on these benefits, one would expect investors to be keen to relocate to these areas and ultimately have benefits flowing from their operations and spillover to the rest of the economy. However, these benefits vary; therefore, the question is: what the international best practice is as far as the SEZ operations are concerned.

Despite the anticipated benefits, the implementation of SEZs has produced a mixed bag of results in emerging economies. This has triggered the need for assessing their influence on sustainable development and the factors that meaningfully contribute to sustainable and inclusive economic growth. Neumark and Kolko (2008) noted that fiscal incentives offered in SEZs do not promote employment and thus do note promote inclusive growth. The literature reveals that SEZs in Africa have performed below expectations. However, more zones continue to be established as countries expand their industries. As a result, there are concerns about whether African countries should consider a different SEZs model or find alternatives.

Given the poor performance of SEZs in fulfilling their establishment purpose in the African continent, this paper seeks to answer the following questions: *What factors determine the success of the special economic zones, and why have SEZs in Africa generally failed?* In order to answer these main questions, the following two sub-questions must also be answered: *What is the appropriate SEZ model for developing economies? When do SEZs generate spillover effects to the rest of the economy while fostering linkages with domestic firms for additional economic activity?*

The objective of this paper is to explore the literature to identify international best practices for successful and effective SEZ-driven industrial policy, with a particular focus on the African continent. In addition, the aim is to establish the reasons behind the failing SEZ model in Africa and examine charter cities as an alternative model.

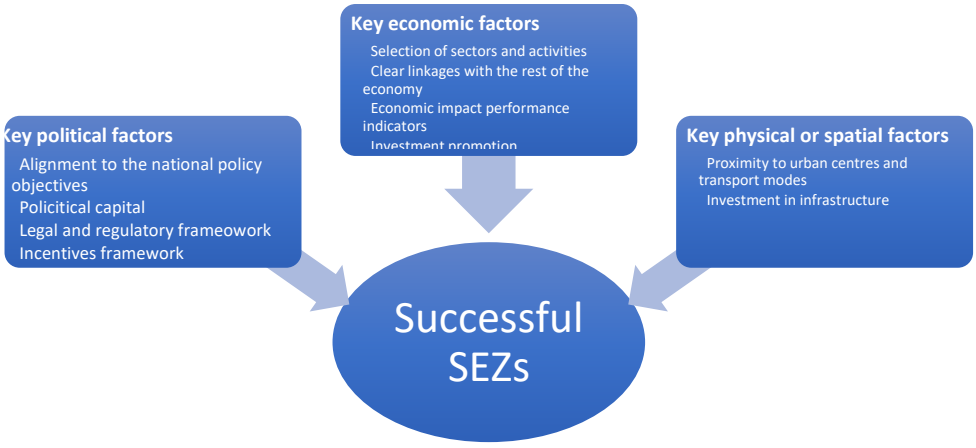
This will enable policymakers to identify areas to improve industrial development strategies to achieve sustainable development goals ultimately. The achievement of SDGs requires that SEZs be redefined in a manner that stipulates their contribution to SDGs and ensures sustainable urbanization. In addition, the Covid-19 pandemic revealed severe challenges related to increased urbanization, leading to densely populated and poorly planned areas. These densely populated areas have also revealed inter-urban inequalities whereby some sectors, such as informal sectors, have suffered the economic consequences of the crisis.

Thus, the question here is: should African countries adopt the charter cities model to foster inclusive growth and sustainable development and contribute to SDGs?

3. Special Economic Zones' best practice approach

To accurately examine the effectiveness of SEZs, the literature on international best practices is used as a benchmark. Figure 2 presents the relevant factors for SEZ success as identified in the literature.

Figure 2: Political, economic, and spatial determinants of SEZ success



According to international best practices, the success of the SEZs is determined by political, economic, and physical or spatial factors (Karambakuwa, Matekenya, Mishi, Jeke, & Ncwadi, 2020; Wessendorp, Kamiya, Bonilla-Feret, & Bonera, 2020). Thus, attention should be given to these factors for SEZs to succeed.

According to the literature, one of the key factors is the alignment of the SEZ strategy to the national policy objectives under the organizational factors. In addition, there must be an apparent and robust reason for establishing an SEZ to ensure that political support is developed throughout its development (Karambakuwa, et al., 2020). Thus, the type of the adopted SEZ model should be aligned to national and regional policy objectives and targets (UNCTAD, 2021; Balasubramanyam, 1988).

Political capital is one critical factor. For example, an SEZ programme with adequate political support warrants a stable atmosphere with reduced uncertainties and is highly attractive to investors (Warr, 1989; Zeng, et al., 2012). Although an agency or a ministry may lead an SEZ programme, effective delivery and program success rely on political leadership's support, buy-in, and commitment. Farole and Moberg (2014) further indicate that the success of SEZs in East Asia was mainly due to the commitment of political leaders. In countries such as China and Vietnam, senior government officials and party leadership were committed to driving the

success of SEZs through creating an enabling environment for successful implementation of SEZs (Newman and Page, 2017). On the contrary, in Tanzania for example, there is little political support for the SEZs programme, and consequently, the zone's success is negatively affected.

In addition, an SEZ should have a dedicated and explicit regulatory and institutional framework, which is different to that applied outside the zone that oversees the zone's implementation. This follows the belief that SEZ-specific rules yield positive outcomes to zone users due to benefits and freedoms not available outside the zones (Karambakuwa et al., 2020). The set-up of the SEZ should be tailored according to the economy's needs, and the design of the regulatory and institutional framework should reduce transaction costs and investment time than in a typical environment. Thus, a one-stop-shop that house all of this is crucial in this regard (Farole and Moberg, 2017; Kinyondo, Newman, and Tarp, 2016).

Successful SEZs programs require careful coordination between policymakers and the private sector to foster investor confidence through transparency and predictability. Further, inter-departmental cooperation and coordination are crucial for the success of SEZs. Furthermore, poor relations among key inter-agencies responsible for implementing an SEZ harm the successful implementation of a zone. This is evident in Nigeria, where conflict between the port authority and the export processing zone authorities affects the integration of the Calabar Free Zone. This conflict between the two agencies has affected the zone's competitiveness (Farole and Moberg, 2017; Kweka, 2018). Lack of coordination within the organization always negatively impacts the overall policy implementation process. According to the literature, privately operated SEZs with a positive and spelt-out relationship between the private operator and the government regulator tend to be more successful. This relationship ensures an alignment of the private operator's revenue objectives with the public sector’s economic and social objectives of the SEZ (Karambakuwa et al., 2020; Dube, Matsika, and Chiwunze, 2020). Thus, a clear operational strategy, coherence, stability, peer support, training and engagement are prerequisites (AEZO, 2019).

Furthermore, incentives are a crucial organizational factor; for instance, operating within SEZs comes with unique benefits, fiscal and non-fiscal incentives. These include tax holidays, exemptions, concessions, reduced tax rates, tariffs, and machinery imported into the zone. In addition, non-fiscal incentives that aim to boost the ease of doing business are even more vital to investors. However, there should be clear timeframes regarding incentives such as tax holidays and repatriation of profits to avoid unsustainable guarantees (Tang, 2020).

Concerning the vital economic sectors, the selection of sectors and activities for SEZs should be following the country's comparative advantages, the region or area within which the zone is designated without any political influence. These should consider the labour force, skills and training levels, proximity, and capacity of input suppliers, as well as access to unique markets - the economic policy objectives should inform all this in the country.

Further, clear linkages with the rest of the economy are crucial to reap the spillover effects of SEZs with private and social benefits to the whole economy. Therefore, SEZs should not

operate as enclaves. Instead, the sectoral composition of existing firms in and around the SEZ determines the zones' success and ensures backwards and forward linkages while facilitating sustainable and inclusive growth through value chains (Zeng et al., 2016).

The rationale behind establishing the zone should also incorporate the envisaged economic impact of the zone. Moreover, there should be specific marketing strategies to promote investments within the zone.

Concerning physical or spatial zones, proximity to urban centres and transportation modes contributes to the success of the SEZ (Wessendorp, et al., 2020). Therefore, establishing SEZs closer to urban centres enables policymakers to achieve sustainable development goals (SDGs) using SEZs to facilitate and sustain urban development. Tang (2020) and Phiri and Manchishi (2020) point out that SEZs in densely populated urban centres effectively achieve the set objectives.

Infrastructure investment is key to the success of SEZs. Farole and Akinci (2011) noted that the infrastructure and administrative environment that firms in economic zones face have a bearing on net production costs. Thus, infrastructure investment and 'integrated clusters' are crucial to ensure connectivity and coordination between different zones and boost performances at the zone and country level.

To this end, these factors remain crucial in the success of special economic zones, particularly in the African context. Thus, the following section presents an overview of SEZs in Africa.

4. Overview of Special Economic Zones in Africa

Although SEZs have been around, the African continent adopted the SEZ approach relatively late; however, these have received considerable traction within the continent. For instance, it is estimated that 237 SEZs and 57 SEZ projects exist in 47 out of 54 countries across the continent (AEZO, 2019). However, it is estimated that only about half of this total is fully operational or fully implemented, while some are still under construction and thus not hosting firms.

Furthermore, the nature of the management of SEZs in the continent varies from publicly owned, public-private partnerships (PPPs) and purely privately owned SEZs. Thus, most African countries adopted public and private governance models; however, there has been a notable rise in partnerships between the private and public sectors to stimulate efficiency.

About 42 percent of SEZs are publicly operated, whereas 32 percent are privately owned, and 26 percent are PPPs (UNCTAD, 2021). This section presents the assessment of SEZ in Africa against the international best approach.

Regarding the critical organizational factors, the literature reveals that the alignment of SEZ programs to national policy objectives augments complimentary support and coordination

with other programs. In the African context, almost all countries have adopted and implemented SEZs. These include South Africa, Mauritius, Tanzania, Zambia, Namibia, Zimbabwe, Nigeria, Malawi, Mozambique, Lesotho, Ethiopia, Ghana, Kenya, and Madagascar. However, research reveals that although most of these countries (South Africa, Zambia, Namibia, Malawi) successfully aligned their SEZ strategy to national policy objectives, such as Zambia's Vision 2030, some countries have experienced challenges in this regard. For instance, there are no specific SEZ policies that guide their implementation in Tanzania, Zimbabwe, and Mauritius. The absence of specific policies adversely affects the program's effectiveness as it is not part of the national planning (Kweka, 2018; UNDP, 2015).

Political capital is one crucial factor amongst political factors – the SEZ programme with adequate political support warrants a stable atmosphere with reduced uncertainties and becomes highly attractive to investors. Although most SEZs in Africa have historically been developed and operated by governments, they have gathered adequate political support, which led to the incorporation of the SEZ policy to planning at all spheres of government. Thus, robust long-term vision and institutional support are necessary for zones' success. However, (Brautigam, et al., 2010) warn against politics that can potentially overshadow the business agenda, which has been the case in Tanzania (Kweka, 2018).

The law governs all SEZs in terms of the institutional and regulatory framework; thus, there must be clear regulations and institutional frameworks. However, the literature reveals that SEZs have faced several challenges, particularly in Africa, including proper institutional arrangements. In addition, stakeholder coordination has proven to be significant shortcomings. As a result, investors in Africa face various barriers, such as weak governance arrangements and inefficient management (Farole and Moberg, 2014). It is further contended that the inadequate or outdated legal, governing, and institutional framework for SEZs in Africa hampers their success while also creating uncertainty for potential investors (Zeng et al., 2012).

Coordination and the zone's structure have been a significant challenge as far as African SEZs are concerned; for instance, there are no clear boundaries between the operator and the regulator of the zone. Ideally, a zone should have a private operator and be regulated by the state. By implication, a partnership between the public and the private sector through PPPs is the most efficient way of running SEZs. Sadly, SEZs have historically been developed, operated, and regulated by governments for the African continent except for a few; this represses development. As a result, they have generally been unsuccessful. Zambia is an example of developing SEZs through the PPP model.

Economic factors also have a significant role in the success of SES. However, the designation of SEZs areas should be driven by comparative advantage in those areas and the need to facilitate economic development. However, the literature reveals that in the context of Africa, most countries have experienced a politically driven proliferation of SEZs which is not aligned to national objectives but satisfies individual interests; no feasibility studies are conducted prior to the designation. Consequently, non-viable areas are designated, and you find resources sparsely spread across all SEZ.

Regarding the linkages with the rest of the economy, the literature reveals that SEZs benefits are expected to spillover to the firms and communities outside the zone. These spillover effects include job creation, development, forward and backward linkages among firms inside and outside the zone. However, Newman and Page (2017) and Karambakuwa, et al. (2020) argue that African SEZs have had limited success in employment creation and notably limited linkages between firms. In addition, the literature reveals that the spillover effects of SEZs have been limited by the zones being designated as single firms rather than geographic areas; this reduces agglomeration, thus increasing transaction costs and the ease of doing business generally. Furthermore, spillover effects have only been limited to directly contiguous areas.

Concerning physical factors, proximity to urban centres, most SEZs in Africa are established near ports and airports. However, there has been a noticeable rise in the establishment of SEZs in landlocked areas. African economies still experience poor infrastructure development challenges despite the rise, including poor rail transport infrastructure, high trade costs, and inefficient port management systems. These vital elements ensure connectivity, coordination, and interlinks between firms and even different zones to boost development. Generally, SEZs in Africa host fewer firms and therefore contribute marginally to curbing national employment and other social ills that countries are grappling with.

5. Why are SEZs not as successful in Africa?

Although Africa adopted the SEZs approach to stimulating its FDI attractiveness, the reviewed literature indicates various challenges that the continent is still grappling with as far as this development intervention model is concerned. For instance, the critical design attributes are missing in these countries; there is generally a weak institutional framework and regulations, political interference in the designation of SEZs, and in some instances, lack of political support and will to promote SEZs. Africa is generally seen as a high risk by foreign investors as it is characterized by political and institutional instability and lacks predictability – this is although governance has been identified as a critical determinant of inclusive growth and sustainable economic performance (Knack and Keefer, 1997; Rutherford, 2001; Gangi and Abdulrazak, 2012; Mougani, et al., 2013; Chidede, 2017). Therefore, the literature emphasizes the importance of establishing solid and high-quality institutions through which property rights are protected. Moreover, the "ease of doing business" factor ultimately attracts more FDI for achieving sustainable development (Gani, 2007; Bellos and Subasat, 2012).

Interestingly, the Corruption Perceptions Index (2015) revealed that Africa's ranking, at 34 percent, is lower than the Developing and Transition Economies' average rankings of 41 percent. Latin America and the Caribbean lead with 51 percent, followed by Asia, which ranks 47 percent, and Oceania, 42 per cent. This lower ranking adversely affects the competitiveness of the continent. Consequently, still grappling with political and

socioeconomic challenges relating to underdevelopment and poverty, national security, interstate and intrastate conflicts, consolidation of democracy and most importantly, poor governance (Chidede, 2017). The African Economic Outlook (2017) and the Mo Ibrahim Foundation Index (2017) add that even though the continent is gradually improving in terms of ensuring citizen participation in decision-making processes, commitment to accountability within decision-making institutions is still below expectations and policy uncertainty remains high, and terrorism is a growing challenge for security. Furthermore, the lack of political will has persisted despite introducing the African Peer Review Mechanism (APRM) to harmonize the region and instill sound governance principles. In addition to weak governance, poor infrastructure development is another critical hindrance to development and growth in the African continent – and the growing urbanization leading to densely populated cities is a growing concern since these are regarded as primary tools for urban expansion.

Based on the above-identified challenges, it is also crucial to remember that the adoption of the SEZ model in Africa was inspired by the success of this model in Asia, notably in China. Therefore, considering the failures, this is perhaps time for African countries to pause and ask this question: is the SEZ model suitable for the African continent? Are there any alternatives?

6. The Charter Cities Model

This is another development intervention model founded and proposed by Paul Romer in 2009. The charter cities are the closest existing analogue to SEZs, but are bigger than SEZs in that they should be about ten square kilometers to accommodate at least 50 000 residents (UNCTAD, 2021). Thus, the idea behind this model is to stimulate both industrial development and residential development through well-governed urban planning.

The idea behind Charter Cities was to promote urban governance, a solution to the challenges of poorly managed urbanization and poverty. Romer (2009) envisaged Charter Cities as quasi-sovereign units within existing states – *new cities with new rules* (Mason and Lutter, 2020). Here the host government devolves authority to the city government except for primary law such as criminal law and treaties; moreover, the cities are still bound by the signed international investment treaties and are not allowed to adopt laws that violate the constitutional rights of residents (Mason and Lutter, 2020; UNCTAD, 2021). The success of charter cities has been noted in Dubai, Hong Kong, Singapore, Shenzhen, and these cities demonstrated the possibility for cities to transform poverty-stricken places into world-class cities

These are newly created cities where the property developer partners with the country government to develop a special jurisdiction but remains under the host country's sovereignty (Mason and Lutter, 2020). These authors rejected the initial idea by Romer that these cities should have their own rules and constitution different to that of the rest of the country. Unlike SEZs that can also be private, public, or developed as partnerships, Charter

cities promote public-private partnerships (PPPs). This is consistent with the literature, which revealed that the PPP governance model is more efficient than other models. Thus, to facilitate growth and development through industrial policy in Africa, the charter city model is the most efficient model African countries should adopt. This development intervention approach is a solution to weak governance, rising urbanization, and poorly developed infrastructure that threatens and undermines future global South development. For instance, in addition to the already rising urban population, the United Nations estimates that the urban population will almost triple by 2050 (Wessendorp et al., 2020). This requires good governance and infrastructure, but proper urban planning does consider not only industrial development but also residential development. To this end, the enforcement of the new rules within the charter cities model is benchmarked to global best practices and, therefore, reduces the transaction costs of doing business while stimulating property rights protection – this ultimately attracts more foreign investors, leading to agglomeration and sustainable development and inclusive economic growth in the cities.

The contribution of the charter cities model to urban planning focuses on facilitating stakeholders' coordination, ensuring all participate effectively and meaningfully. For instance, proper coordination among ministries responsible for urban planning and economic development and fiscal matters, sectoral ministries and specialized agencies, public-private partnerships, city-level public actors, local urban planning authorities, as well as investment promotion agencies at all spheres of government need to participate as strategic partners actively is facilitating investments. This ensures that city developments are appropriately aligned with the planning strategies, government objectives and maximize synergy while also stimulating cooperation that ultimately leads to their effectiveness. It is worth noting that stakeholder coordination has been identified as one of the significant challenges in SEZs; thus, adopting the PPP model across the continent would require the government to enhance capacity to forge new partnerships, new institutional structures, and new funding models.

7. Conclusion and recommendations

The literature identified good governance as a primary contributor to sustainable economic prosperity. However, African countries are still grappling with this challenge; as a result, special economic zones that stimulate economic prosperity through inward foreign direct investment do not seem suitable in the African context. Hence the charter city model is considered a solution to the rising urban population rates, poorly developed infrastructure, and weak governance. Furthermore, this model allows city authorities to develop policies suitable for development at that level rather than waiting on the national government to intervene. Thus, instead of importing models that are not suitable for African contexts, African countries should consider adopting charter cities that simultaneously promote residential and industrial development while also mitigating governance issues.

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