SUPPORTING ECONOMIC TRANSFORMATION

# HOW DO CHINESE 'SPECIAL ECONOMIC ZONES' SUPPORT ECONOMIC TRANSFORMATION IN AFRICA?

BRIEF

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# INTRODUCTION

Africa is no longer satisfied *with growth that is limited to traditional economic sectors*, such as agriculture or mining. Policy-makers aiming to bring in more manufacturing, technology and innovations to the continent are attaching more importance to structural transformation in their vision of development. In this context, a handful of ‘special economic zones’ (SEZs) established in Africa by Chinese firms are especially interesting. Firstly, these zones have concentrated an increasing number of manufacturing investment projects from China and other countries. Secondly, SEZs played a significant role in China’s own economic transformation during last three decades. [1] Why did Chinese investors set up these zones in Africa? How do these zones affect the economic transformation in Africa? What can be done to maximise their positive impacts? This brief will offer a brief analysis to answer these three questions.

# 1) WHAT ARE THE MOTIVES OF CHINESE FIRMS TO ESTABLISH SEZS IN AFRICA?

Chinese enterprises, both state-owned and private ones, have been investing in various SEZs in Africa since the late 1990s. As Chinese firms began to enter the African market, several Chinese companies leased small pieces of land, set up industrial housing, and had necessary facilities arranged to host the newly arriving investors. In correspondence with growing Chinese investment overseas, China’s Ministry of Commerce (MOFCOM) launched a programme to support the construction of overseas economic cooperation zones from 2006 to 2007. In total, 19 zones were selected, of which seven are in Africa: Algeria, Egypt, Ethiopia, Mauritius, Nigeria (two), and Zambia.[2] The developers of the selected zones had more ambitious plans than those of previously created zones. Each zone was required by the MOFCOM to cover an area of at least 5 sq. km. Though the Chinese government did not involve itself in the design or direct operation of the cooperation zones, it provided various forms of financial support, including subsidies of up to 200 million RMB ($33 million) for each zone, with the loan arrangements and equity investment provided by the China-Africa Development Fund. These cooperation zones have experienced a bumpy and slow start mainly due to unexpected political, financial and cultural challenges. By early 2015, the stronger zones, such as Egypt TEDA and Zambia Chambishi, had hosted 20-30 producing factories, and the zone in Mauritius had not yet begun operations.

Despite the slow progress in the cooperation zones, China’s zest for SEZs in Africa did not wane. While the existing zones continue growing, several new Chinese-invested zones have been set up in Uganda, Nigeria, Mozambique and Ethiopia apart from the MOFCOM program. More importantly, China’s ‘one belt, one road’ grand plan in 2015 states, ‘We should explore a new mode of investment cooperation, working together to build all forms of industrial parks, such as overseas economic and trade cooperation zones and cross-border economic cooperation zones, and promote industrial cluster development’.[3]

[1] SEZs can be broadly defined as demarcated geographic areas contained within a country’s national boundaries where the rules of business are different from those that prevail in the national territory. It include industrial parks, free trade zones (FTZs), export processing zones (EPZs) and various other forms of delimited areas with special economic regulations.

[2] However, the Algerian zone later withdrew from the program because of unexpected changes in Algeria’s legislation governing foreign investment.

[3] ‘Vision and actions on jointly building Belt and Road’, National Development and Reform Commission, Beijing, 28 March 2015.

**Table 1. Overview of China-Africa economic cooperation zones supported by MOFCOM**

| Country | Zone name | Location | Tender year | Original lead Chinese developer/later lead developer | Status | Area (phase I) | Area (Total) |
|---|---|---|---|---|---|---|---|
| **Algeria** | Jiangling | Oran City | 2007 | Jiangling Automobile Co. | Suspended | 120 | 500 |
| **Egypt** | China-Egypt Suez | Suez | 2007 | Tianjin TEDA Co. | Operating | 134 | 634 |
| **Ethiopia** | Eastern | Dukem, Addis Ababa | 2007 | Yonggang /Qiyuan Investment Group | Operating | 233 | 1000 |
| **Mauritius** | Jinfei | Terre Rouge | 2006 | Tianli/Three Shanxi companies | under construction | 70 | 211* |
| **Nigeria** | Lekki | Lagos State | 2007 | CCECC | Operating | 109 | 1000 |
| **Nigeria** | Ogun-Guangdong | Ogun State | 2006 | Guangdong XinGuang Group | Operating | 250 | 2000 |
| **Zambia** | Zambia-China | Chambishi / Lusaka | 2006 | China Nonferrous Metals Corporation | Operating | 200 | 1158 |

*Mauritius zone has changed its plan and focuses now on finance and tourism. Therefore it does not need to meet the 5 sq. km requirement.

Based on Bräutigam and Tang, 'African Shenzhen: China's special economic zones in Africa', Journal of Modern African Studies, Vol. 49, No. 1, 2011, pp. 27, 32, with updates by the author through interview and email communication.

The reason for China's enthusiasm for Africa's SEZs is closely related to China's domestic SEZ experience. China is regarded as the world's foremost success story when it comes to using SEZs to build up industrial capacity.[4] The creation of SEZs played a strategic role in China's early economic reforms. Tens of thousands of Chinese firms operate in hundreds of SEZs in China. Consequently, when these firms move overseas, they look for similar investment environments. In addition, SEZs have the advantage of providing better facilities and services when the overall infrastructure in Africa is still deficient. Clustering of firms along the value chain can also reduce transaction costs. Chinese-run SEZs make Chinese expats 'feel at home' in terms of culture and language.

For the developers of Chinese zones in Africa (see table 1), the direct revenue comes from rent and service fees paid by tenants. However, in the early stages of zone development, the number of tenants is too small to pay back the enormous amount of investment in infrastructure. Therefore, SEZ construction is a long-term investment. The developers' main profit will ultimately come from the value increase of land once a zone is turned into an industrial and commercial hub like Shenzhen. Obviously this leads to an extremely long return period. In China, an SEZ required 12-15 years, on average, to become mature. In Africa, it probably needs longer due to cultural differences, administrative inefficiency, and lack of infrastructure outside the zone.

Therefore, the Chinese government's subsidies and financing assistance play a major role in encouraging Chinese firms to develop SEZs in Africa, particularly large ones. Other forms of political support – for example, the visits of top leaders – also give incentives to the developers, no matter if they are state-

[4]Foreign Investment Advisory Service . 2008. Special Economic Zones : performance, lessons, learning, and implications for zone development. Washington, DC: World Bank.

owned enterprises or private firms. Indeed, the Chinese government frequently takes actions to motivate the SEZ developers. Not only did former president Hu Jintao and former premier Wen Jiabao visit zones in Zambia and Egypt, but the government has also helped promote these zones to Chinese firms and has now included cooperation zones into the ‘one belt, one road’ strategy. The Chinese government hopes that overseas SEZs can both facilitate Chinese enterprises to invest abroad, and transfer China’s development experience to other countries.

# 2) WHAT ARE THE EFFECTS OF SEZS ON ECONOMIC TRANSFORMATION IN AFRICA?

The existing Chinese zones in Africa have so far demonstrated some promising effects on Africa’s economic transformation, but they also face challenges and obstacles (table 2). First, the five operational zones emerged as small manufacturing powerhouses in their host countries. The Eastern zone in Ethiopia has the largest shoe factory in the country. In addition, a dozen firms formed a cluster of textile apparel production and a cluster of construction materials production. The zone in Chambishi, Zambia, has developed a group of mineral processing plants. The firms in two Nigerian zones mainly produce construction materials and consumer goods. The Egyptian zone also produces machinery. Most of the manufacturing investors in the zones are from China, but a small number of local manufacturers and investors from third countries also operate there in the zones. The five zones combined had created around 20,000 jobs for Africans as of February 2015.[5] All these Chinese zones target manufacturing enterprises as their priority clients because Africa’s market offers immense opportunities for Chinese manufacturers. Furthermore, China’s rising labour costs are pushing companies to seek alternative production bases. As the Chinese zones in Africa grow, they may bring in a significant amount of foreign direct investment in the manufacturing sector with managerial know-how and accelerate Africa’s industrialisation.

**Table 2. Investment of six China-Africa economic cooperation zones (circa February 2015)**

| | Zone constr. invest-ment ($ mil) | No. of tenant com-panies (signed) | No. of tenant com - panies (in oper-ation) | Tenant company commit-ments to invest ($ mil) | Tenant company actual invest- ment ($ mil) | Tenants: approx. no. of Chinese workers | Tenants: approx. no. of African workers |
|---|---|---|---|---|---|---|---|
| **Egypt TEDA** | 93.42 | 58 | 38 | 610 | 357.6 | n/a | nearly 2000 |
| **Zambia Chambishi** | 170 | 45 | 26 | 1300 | 322 | 1372 | over 8000 |
| **Nigeria Lekki** | 82.5 | 30 | 8 | 700 | 76 | n/a | 300 |
| **Mauritius Jinfei** | 38.31 | 5 | 0 | n/a | n/a | n/a | n/a |
| **Nigeria Ogun** | 23.7 | 40 | 19 | 150 | 58.28 | 200-300 | 4250 |
| **Ethiopia Eastern** | 88.9 | 25 | 10 | 192.4 | 159.2 | 390 | 4975 |

Based on Bräutigam and Tang, ‘Going Global in Groups: China’s Special Economic Zones Overseas’, *World Development*, Vol. 63, 2014, p.86, with updates by the author through interviews and email communication.

Second, the Chinese zones in Africa provided examples of streamlining administration and improving infrastructure construction and management for Africa’s economic reform. After years of struggling with local authorities, Chinese zone developers in Africa have achieved certain progresses to facilitate industrial investment. For example, the Nigeria Ogun zone has managed to shorten the customs clearance time from two weeks to five days. This zone together with the Chinese-owned Nigeria Lekki zone became the only two zones, out of the country’s 21 zones, that can supply power 24/7. The Eastern zone persuaded

[5] Interviews and email communication with zone developers.

the Ethiopian government to use financial incentives for the first time in an SEZ to attract foreign investors. Moreover, the experiences from these improvements in the Chinese zones have been adopted and extended by African authorities to the broader economy. Ethiopia is setting up a plan of launching four or five SEZs after the Eastern zone model. The Zambian government revived and reformed its SEZ programme (named MFEZ by the Zambian authority) with the Chinese-owned Chambishi zone as a model. Chinese zones in Africa have in fact become platforms for Chinese and Africans to share experiences, discuss policy issues, and work together to achieve pragmatic changes on the ground.

Last but not least, the Chinese zones may contribute to Africa's urbanisation in the long run. A Chinese manager in the Egypt-TEDA zone said, 'The ultimate goal of the cooperation zone is urbanisation. We aim to build a new modern metropolis like Shenzhen.'[6] As noted earlier, the developers can get substantial profit only when the land value increases. Therefore, the Chinese developers do not merely develop industrial facilities but also build commercial and living areas nearby to enable synergic growth. Every zone in Africa has a blueprint for building a new industrial city. African authorities generally like this idea. The Lagos state government officially recognised the Lekki zone as the first step in its master plan of building a new Lekki city. Although the realisation of this goal may seem remote, Chinese developers appear to take it seriously, for they have seen the incredible transformation of villages into metropolises not long ago in their own country.

## 3) WHAT CAN BE DONE TO MAXIMISE IMPACTS TOWARDS ECONOMIC TRANSFORMATION?

Currently, the biggest obstacle to the Chinese zones in Africa maximising their impacts is the lack of local linkages. A large number of the Chinese manufacturers in the zones import almost all of their raw materials from China. They process the materials in Africa in order to obtain financial incentives. This business model may turn the zones into production 'enclaves' isolated from the host countries' overall economies, thus preventing broad industrialisation. SEZs in China paid much attention to building linkages. The developers had foreign investors frequently meet local suppliers outside the SEZs to establish connections. They also intentionally invited upstream and downstream producers to invest in the SEZs together, to build a complete value chain and supplier network. The Chinese government trained tens of thousands of officials by having them visit successful SEZs, take courses on SEZs, or participate in SEZ practice for a certain period of time. Africans may borrow some of these measures to accelerate skill transfer.

Another critical point is to increase Africa's ownership in the Chinese zones. Except the Nigeria-Lekki zone, where the Lagos state government takes 40% of the shares in the zone, the Chinese zones rarely have Africans in their senior management. This has led some African governments to consider the zones merely as Chinese projects. However, experiences of zone development in Asia showed that successful SEZs need to have more ownership by host countries' governments. If the goal of enabling broader transformation is to be achieved, SEZs need supporting measures and policies from local authorities. Host country representatives should also participate in the management of SEZs to track and maximise their impacts on the local society. Overall, Chinese zones need to enhance their connection with host countries in multiple dimensions so that the zones and the countries can grow hand in hand.

Chinese firms are likely to continue developing larger and more SEZs in Africa, as the expansion of Chinese business on the continent keeps strong momentum. According to a Chinese zone manager, several of these zones may take off and achieve explosive growth within the next 5 to 10 years. Consequently, more research is needed to track the development of these zones and evaluate their impacts in more depth. While Sino-African cooperation on SEZs has the potential to contribute significantly to African economic transformation, concerns about limited local linkage and ownership ought to be better

[6] *Interview with Mr. Fu, a manager in the Egypt-TEDA zone* July 2009.

addressed. Analysis of the connection and interaction between SEZs and broader development is lacking today. More examination in this regard will be particularly helpful for us to understand the long-term effects of such zones.