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**The American University in Cairo  
School of Humanities and Social Sciences**

**The Role of  
China's Overseas Special Economic Zones  
in Economic Development**

*A Thesis Submitted to  
Department of Political Science*

**In partial fulfillment of the requirements  
for the degree of Master of Arts**

**by Salah El-Rashidy  
under the supervision of Dr. Javed Mswood**

**August 2016**

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# Introduction

## **Background:**

Special Economic Zones have the reputation of being catch-up vehicles by which less developed countries can stimulate economic competitiveness, and consequently economic development. In many ways, SEZs are different from other types of zones, like Free Trade Zones and the export-oriented Export Processing Zones. SEZs are larger in scale and follow a more comprehensive approach of integrated development. Typically, SEZs are intended to serve certain objectives: 1) attract foreign direct investment, 2) create jobs, 3) induce economic reform, and 4) test innovative economic policies. SEZs are considered successful if they were able to bring about significant structural change in the economy or, as dubbed by Thomas Farole, long-term “dynamic economic benefits” which indicates achieving a significant level of diversification and openness, in addition to facilitating the transfer of knowledge. The impact of a SEZ is largely dependent on the degree of integration in the domestic economy, in terms of backward and forward linkages, exchange of skilled labor, and attracting domestic investments. (Farole and Akinci, *Special Economic Zones: Progress, Emerging Challenges, and Future Directions* 2011)

Owing to such favorable outcomes associated with SEZs, and as part of its “Going Global or Zou Chuqu<sup>1</sup>” policy, the Chinese government announced in 2006 its intention to establish more than 50 overseas economic and trade cooperation zones globally, a good share of which will be set in the African continent. The Chinese investment in overseas SEZs has been perceived as an attempt to reincarnate the Shenzhen experience in Africa. Shenzhen was the first SEZ in China back in 1980s that harbored incoming FDI offering special legal and regulatory conditions, with less bureaucracy and reduced taxes, to attract foreign investors. (Hong 2010) The Shenzhen model was, later on, in other areas inside China, breaking ground for unprecedented economic growth across

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<sup>1</sup> Zou chuqu means walk out in Chinese. (Brautigam 2009)

the country. The effectiveness of China's overseas investments in SEZ is yet to be evaluated. What has worked for China may be hard to achieve in other developing countries.

*Problem Statement, Research Objective and Hypothesis:*

The Chinese overseas SEZs came to offer a courageous, interesting model of economic development that, if successful, will generate favorable economic outcomes that extend not only to the hosting county but also to the country providing the investment opportunity. Indeed, this model has demonstrated some miraculous results inside China, driving the economy to unprecedented altitudes of growth. Nevertheless, little evidence has been set forth to display the ability of Shenzhen model to stimulate similar triumphs outside of China. To prove its validity as an effective tool, rigorous investigation needs to be put in place to assess the performance of the Chinese overseas SEZs, and more importantly to verify their contribution to the economy of hosting countries, or otherwise it will only qualify as an ambitious strategy developed by China to pursue its foreign policy agenda.

The Chinese model of overseas SEZs emerges as one of the promising initiatives that gains considerable reputation from its amazing success in China. However, to be able to give full credit to this model, evidence should demonstrate its feasibility in developing countries where it has been put into action and to ensure that the element of reciprocity of benefit between China and the hosting country exists. For that purpose, this study will be working to provide an answer to one major question: **“Can China's overseas SEZs stimulate economic development of host countries?”** Two sub-questions emerge from this principal research question as follows:

- 1) What are the pathways through which SEZs can contribute to economic development? What are the potential economic gains that are associated with SEZs in general, and how those gains were realized in the case of China's domestic SEZs, which can serve as benchmarks of success, given their undeniable role in China's economic growth?

- 2) In light of the framework of potential economic benefits derived from the literature on SEZs and verified through the study of China's domestic SEZs, particularly Shenzhen, have China's overseas SEZs, thus far, been able to help host countries attain the benefits associated with SEZs?

### ***Theoretical Framework:***

To determine the economic benefits of SEZs, the literature on SEZs appear to resort to either of two schools of thoughts; namely 1) the orthodox approach and 2) the heterodox approach. Subscribing to the neoclassical economic theory, the orthodox approach looks only into the static effects of SEZs. Benefits that are significant for this approach involve inflows of foreign investment, generation of direct employment opportunities, and earnings of foreign exchange derived from exports. On the other hand, the heterodox approach embraces the concepts put forth by the new institutional economics, the endogenous growth theory and the new economic geography, which principally acknowledges the importance of the indirect, but dynamic gains attributed to SEZs, like linking the local economy of the host country with global value chains, creation of industrial clusters, the transfer of technology and skills development.(Warr and Menon 2015) In this dissertation both approaches shall be taken into account to embrace all sorts of potential benefits that can be generated by China's overseas SEZs in favor of host countries.

### ***Outline:***

In line with above, this research will have two major parts each addressing one of the two research sub-questions. Part One will build a framework for evaluating the impact of China's overseas SEZs, first in Chapter I, by browsing relevant models in the literature on SEZs that can help identify the potential channels through which SEZs can contribute to economic development. And then, in Chapter II, China's domestic SEZs shall be introduced to provide actual data that can work as benchmarks for the gains to be expected from the overseas SEZs. In Part Two, China's program of overseas SEZs will be

evaluated through the framework established in Part One. Chapter III will, first, introduce the Chinese initiative while briefly reviewing the participating SEZs and their overall performance. Then, in Chapter IV, three SEZs under the Chinese program will be thoroughly examined to determine their progress, thus far, and their ability to generate favorable outcomes that can stimulate economic development in the host countries.

### *Methodology:*

This dissertation shall be looking into three of the major cases of China's SEZs in Africa; 1) China-Egypt Suez Economic and Trade Cooperation Zone (SETC Zone), 2) Ethiopia's Eastern Industrial Zone (EIZ) and 3) Zambia-China Economic and Trade Cooperation Zone (ZCCZ) with an aim to investigate the different facets of the experience and to assess the accomplishments of the three project thus far. The three cases of the SETC Zone are selected for this thesis, being among the few already-operating zones under the Chinese overseas SEZs program.

This investigation will, however, require calling in China's domestic SEZs, and particularly Shenzhen's experience, as a benchmark against which the performance of the three African zones will be gauged. Comparing the performance of the three zones, in light of the undisputed variances between the three countries in terms of the prevalent economic, political and institutional conditions, will bring about some insightful conclusion with regards to the flexibility of China's overseas SEZ and its resilience to the diverse contexts of the countries of the global South.

The dissertation will invite in few tools of quantitative analysis, especially in parts where the achievements of the zones are set side by side, this study basically relies on qualitative research methods, as appropriate. In addition, several sections of the dissertation, particularly the one assessing the SEZ of Egypt, had in-depth, face-to-face interviews as the main tool for data collection. One interview was conducted with a senior economic researcher in the Ministry of Investment who manage the portfolio of the SETC Zone, while another was held with the General Manager of Planning and Implementation in the Main Development Company (MDC), the main developer of the



zone. Most importantly, a very successful interview was held with two marketing directors in the Chinese TEDA, the developer and designer of the SETC Zone. The data collected from these interviews are, of course, complemented by an in-depth review of relevant primary and secondary sources, including agreements, progress reports, contracts, etc.

***Significance of Research:***

This thesis will add to the ongoing debate on the significance of SEZs as a workable instrument for developing countries to attain economic development. More particularly, this thesis will have a very significant implication, either to confirm the viability of China's overseas SEZs and, hence, support their replication in developing countries, or deny its ability to fulfill its propagated outstanding results.

## **Part I**

### **Special Economic Zones and Economic Development**

The aim of Part One, through its two chapters is to set up a solid framework for assessing the impact of SEZs, in general, on the economic development process in the host countries. Chapter I, first, scans previous works on SEZs in search for theories and models that managed to touch upon the mechanisms by which SEZs can work as catalysts for growth and development. The theory will, then, be reinforced, in Chapter II with real-life facts and figures drawn from the Chinese own experience with SEZs that will help better evaluate China's overseas SEZs, later on, in Part Two.

## Chapter One

### Special Economic Zones as an Instrument of Economic Development: Theoretical Framework

The theoretical debate over the concept and role of SEZs in economic development, in addition to their gender, labor and environmental implications, can be grouped under two major types of analysis, as argued by Farole; 1) formal analysis with the intense theoretical content and 2) the descriptive and case-study-based research, which was increasingly sponsored by international organizations, like the World Bank, UN agencies, and the OECD. These two types of analysis have been especially influenced by three theoretical streams: 1) trade-related approaches, 2) cost-benefit assessments, and the blooming 3) endogenous growth. (Farole 2011) Among this wealth of literature, this chapter will be looking for a well-established framework to assume throughout the following chapters.

#### I. What is a Special Economic Zone?

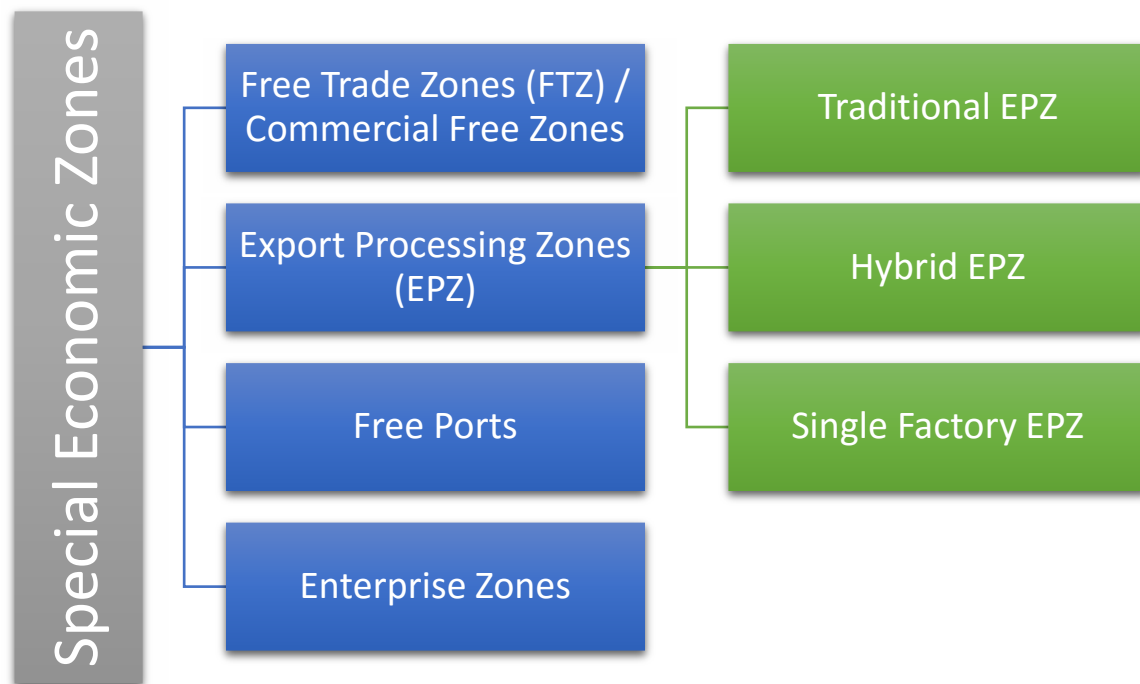
Special economic zones (SEZs) “are spatially delimited areas within an economy that function with administrative, regulatory, and often fiscal regimes that are different (typically more liberal) than those of the domestic economy. SEZs aim to overcome barriers that hinder investment in the wider economy, including restrictive policies, poor governance, inadequate infrastructure, and problematic access to land.” (Farole, Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience 2011)

This definition clearly echoes the four principles put forth by the World Bank’s Foreign Investment Advisory Service (FIAS) to characterize SEZs. They are: “1) geographically delimited area, usually physically secured, 2) administered by a single body, 3) offering certain incentives (generally duty-free importing and streamlined customs procedures) to businesses 4) physically located within the zone.” (The Multi-Donor Investment Climate Advisory Service FIAS 2008)

**Types of SEZs:**

In the literature, SEZs have been positioned differently vis-à-vis the other types of economic zones. The most adopted typology has put SEZs as generic term that refers to a variety of economic zones, as follows:

*Figure 1*



(The Multi-Donor Investment Climate Advisory Service FIAS 2008)

SEZs, themselves were classified among five distinct forms of economic zone, namely: Industrial Parks, Eco-Industrial Parks, Technology Parks and Innovation Districts. This categorization finds SEZs and Industrial Parks to best designed for less developed countries that are in desperate need for attracting FDI inflows to contribute to employment and to tighten the technological gap. This categorization then includes under the framework of SEZs Free Trade Zones, Export-Processing Zones, in addition to Free Ports and Enterprise Zones. (UNIDO Country Office in Vietnam 2015)

Other typologies consider Industrial Zones as one form of SEZs. Economic and Technical Development Zones have also emerged as a SEZ. (Zhang and Ilhéu 2014)

***Historical Background:***

The first SEZ, in its modern form, was established in Shannon, Ireland in 1959. (Amirahmadi and Wu 1995) Indeed, the SEZ concept has existed for centuries, mostly as zones that are exempted from regular customs. SEZ, in particular, is found to be the contemporary version of the free ports that existed during the Roman Empire era, and more recently in Hong Kong and Singapore. However, the SEZ in Shannon was the first to introduce export-oriented manufacturing to a customs-free area. Since then the model was replicated in many parts of the world. (UNIDO Country Office in Vietnam 2015)

SEZs have been gaining ground since the 1960s in Asia, Latin America and Africa. In mid-1980s, only 176 SEZs were found operational in 47 countries. At that time, SEZs, especially in the form of Export Processing Zones, helped many developing countries successfully migrate from import-substitution to export-promotion strategy. By 2006, the number of SEZs skyrocketed to 3,500 operating across 130 countries with total employment of 66 million, 60 percent of which were working for SEZs in China. (Warr and Menon 2015)

## **II. SEZs Contribution to Economic Development: Literature Review**

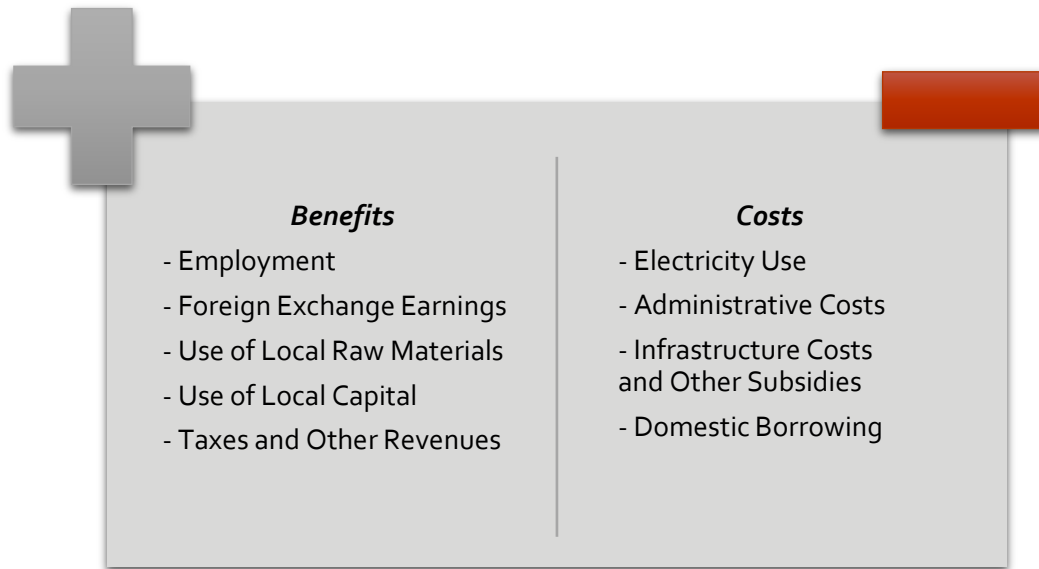
As mentioned, the literature on the role of SEZs can be fitted under two types of research; 1) the formal analysis that follows rigorous theoretical standards, and 2) the descriptive and case-studies-based research, spearheaded by major international organizations. Two major lines of thought were, particularly, present within these two types of analysis; a) the Orthodox Neoclassical approach, and b) the Heterodox Endogenous Growth perspectives.

### ***The Orthodox Neoclassical Approach:***

The formal analysis of SEZs was initially dominated by the work of the neoclassical economists who have entirely shaped the orthodox approach to SEZs. largely building on the seminal contribution of Koichi Hamada in 1974 through his article “An Economic Analysis of the Duty-Free Zones.” Based on the fundamentals of the international trade theory, Hamada’s view of duty-free zones was notably pessimistic. For him, duty-free zones were a “distortive policy tool” utilized to fix a prior distortion. Hamada argues that the preferential policies applied within duty-free zones came to offset the distortive trade arrangements of high tariffs, quotas and other trade restrictions. In an open, liberal trade system, the incentives offered through duty-free zones are of no use. (Hamada 1974) Hamada’s pessimism seems to have proliferated among other neoclassical approach, where duty-free zones and, eventually, SEZs emerged, at best as second best option to trade liberalization. And, hence, the impact of SEZs is only valued as a transitional step towards full liberalization of the economy

The neoclassical economics work was further reinforced by some empirical cost-benefit assessments, the most significant of which was done by Peter G. Warr in 1989. In his analysis, Warr contrasted potential benefits of EPZs against costs as follows:

Figure 2



(P. G. Warr 1989)

Warr's conclusion came to confirm the neoclassical assumptions regarding SEZs. According to Warr, "the benefits from EPZs are limited. They are definitely not engines of development." The only gains generated by EPZs were their ability to absorb surplus labor. Warr downplayed the weight of indirect, dynamic effects. (P. G. Warr 1989)

Almost the same conclusion was brought about by Kankesu Jayanthakumaran's more updated cost-benefit analysis in 2003. Jayanthakumaran gave credit to SEZs only for their role in employment and tax earnings. (Jayanthakumaran 2003)

The orthodox approach was, equally, reflected in descriptive research and case studies that only acknowledged the direct static gains of SEZs, primarily employment, while denying their potential to stimulate economic development.

### ***The Heterodox Perspectives:***

The heterodox approach embraces the concepts put forth, in the late 80s and early 90s, by the new institutional economics and the endogenous growth theory, which, despite their theoretical variations, have assumed matching perspectives that largely abandons

the neo-classical view of the impact of SEZs on economic development. On the one hand, the new institutional economics, in direct conflict with the neoclassical fundamental assumption of *human rationality*, argues that institutions are important to “reduce uncertainty in human exchange” building on that belief that “the incomplete information and limited mental capacity by which to process information determines the cost of transacting” (C.North 1995) For new institutionalists, reducing transaction costs is key to economic development. Less developed countries have to endure low levels of investment and productivity in light of the high transaction costs they maintain, by cause of the poor property rights systems and the inadequate access to business-related information, in addition to the unreliable contractual frameworks. (Shirley 2005) In that sense, the role of SEZs is appreciated by the new institutionalist approach, being an instrument that can foster reliable exchanges through entrenching conducive business environments that are not only confined to the boundaries of SEZs, but also extends through the linkages with the local economy.

From a different standpoint, SEZs seem to work for new “endogenous” growth theorists, being, at least in theory, knowledge-generating habitats, a quality that is particularly valued under this approach. In fact, the principal argument of the new growth theory is that “knowledge and technology are characterized by increasing returns, and these increasing returns drive the process of growth.” (Cortright 2001)

Despite their conceptual variations, these two major theoretical streams form the foundations of the heterodox perspective to the role of SEZs in economic development, acknowledging the importance of the indirect, but dynamic gains attributed to SEZs, like linking the local economy of the host country with global value chains, creation of industrial clusters, the transfer of technology and skills development. (Warr and Menon 2015)

The contribution of the heterodox approach was, mostly, promoted through descriptive research and case studies, obviously, due to that fact that the very legitimacy of this approach was, largely, founded on the success stories of SEZs playing a pivotal role in



the development strategy in less developed countries. In this context, the Mauritius case was central in providing substantial data to support the underpinnings of this approach. (Farole 2011)

***Congregating Perspectives: Towards an All-Embracing Approach:***

More recently, the literature on the role and impact of SEZs has become less and less polarized, thanks to the work of Thomas Farole and some other practitioners, who have found ways to bring the orthodox perspective of SEZs as “welfare-reducing enclaves” that, at best, can only generate static gains of limited economic effect together with the heterodox approach, which appreciates the catalytic role of SEZs and their dynamic, integrating developmental impact.

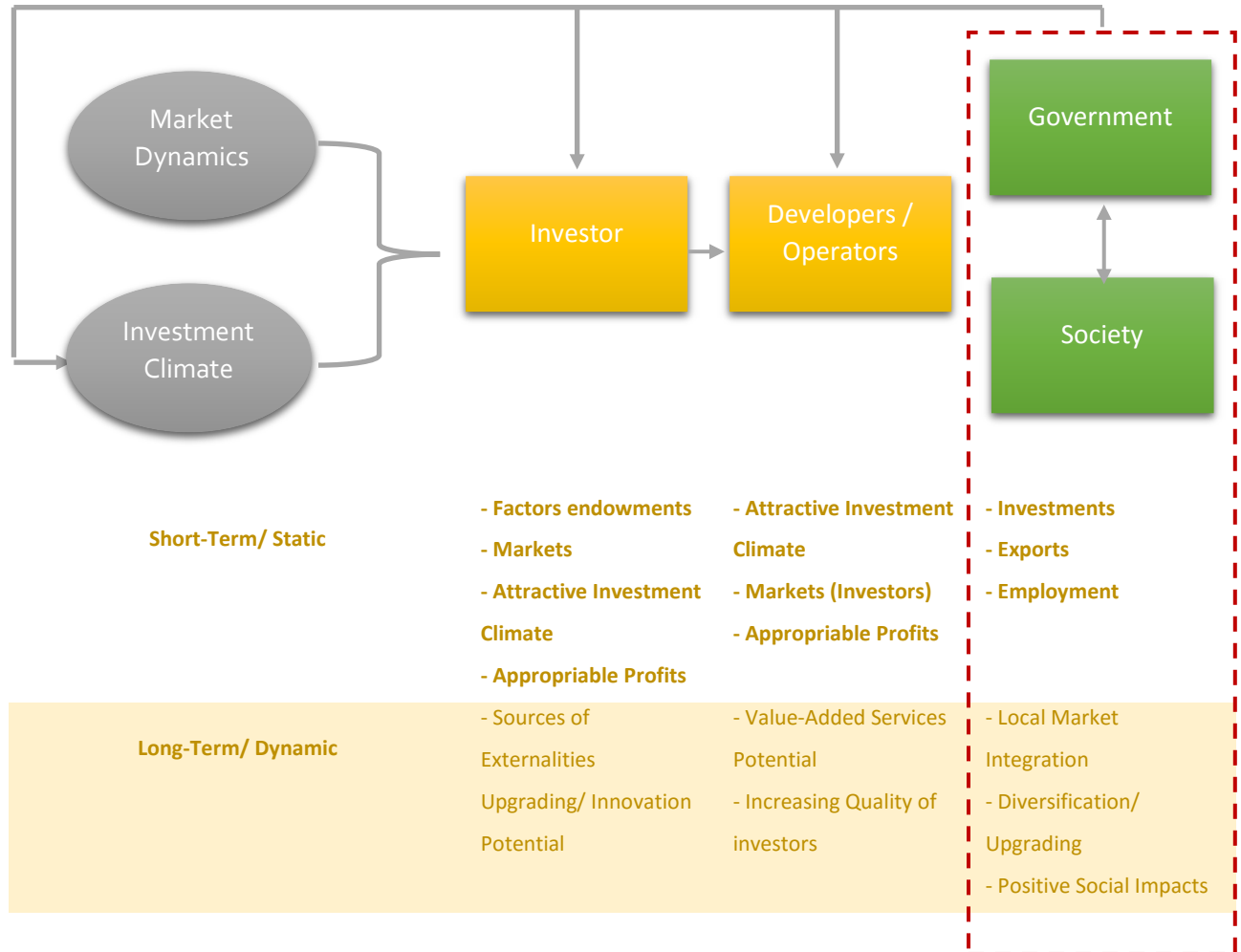
For Farole, it was as simple as integrating the presumptions of both approach within one statement. In Farole’s own words: “SEZs have the potential to act as catalytic exclaves that announce and prepare for liberalization under certain circumstances and provided certain prerequisites have been addressed. If not, SEZs may, at best, provide limited economic benefits for a limited period and, at worst, may turn into welfare enclaves that restrict countrywide liberalization.” (Farole 2011)

Another valid attempt was initiated by UNIDO’s office in Vietnam, where they have managed to bring the opposites together, by matching the contribution of SEZs against the different stages of development. Definitely, less developed countries are different in terms of economic development and competitiveness. The expected impact of SEZs will, therefore, be highly dependent on the development stage to which the host country belongs, ranging from static benefits for the least developed to more dynamic gains for the more advanced economies. (UNIDO Country Office in Vietnam 2015)

Building on his congregating approach, Farole has developed a framework to assess the impact of SEZs as follows:

Figure 3

Framework for Assessing the Outcomes of Economic Zones



(Farole 2011)

It is important to note that the World Bank has come up with almost the same list of potential benefits of SEZs, just as Farole did, only to add “government revenues” to the possible direct/ static benefits, and “policy experimentation” and “demonstration effect” to the indirect/ dynamic benefits. (Zeng, How Do Special Economic Zones and Industrial Clusters Drive China’s Rapid Development? 2011)

### ***Conceptual Framework:***

In view of the above, it is quite evident that literature on the economic impact of SEZs has gradually dismissed the theoretical polarization it has once embodied, and opted for more pragmatic, compromising approaches. Farole's framework represents one significant attempt in this regard. Indeed, Farole, through his approach, was able to establish an all-encompassing framework to assess the impact of SEZs, that equally acknowledges their "limited" short-term static benefits, and also their potential to generate more extensive, long-term dynamic gains, not only for the host country, but also for investors and developers. An exhaustive research on the role of SEZs in economic development will, certainly, find in Farole's framework the ultimate blueprint for a solid assessment that does not rule out any probable aspect of progress that SEZs can bring about. For that very reason, this dissertation will be following Farole's outline in its evaluation of China's overseas SEZs. A detailed description of the layout of the conceptual framework, used in the dissertation, and its different outcome indicators comes next in the upcoming section.

### **III. Attaching Static to Dynamic Economic Benefits: Outline for SEZs Impact Assessment**

To stay relevant to Farole's framework, it is important to adhere to his distinction between SEZs static and dynamic economic benefits, as follows:

### Static Economic Benefits

- Benefits "derived in the relatively short term through the use of economic zones as instruments of trade and investment policy. They include employment creation; the attraction of foreign direct investment (FDI); the generation of foreign exchange through exports; and the creation of economic value added."

### Dynamic Economic Benefits

- Benefits that "include the promotion of nontraditional economic activities, hard and soft technology transfer, the encouragement of domestic entrepreneurship, and the promotion of economic openness."

(Farole 2011)

Taking advantage of Farole's compromising approach, demonstrated in Figure 3, this research will be only focusing on the benefits realized by the host country, represented in the government and society. For that purpose, 5 impact/ benefit indicators will maintain the core structure of the assessment performed for China's overseas SEZs in Africa, as follows:

## Static Economic Benefits

- Foreign Direct Investment
- Employment Creation
- Exports Growth

## Dynamic Economic Benefits

- Local Market Integration and Linkage with Global Value Chains:
- Export Diversification

### **A. Static Economic Gains:**

#### ***Foreign Direct Investment:***

Foreign direct investment inflows represent the cornerstone of SEZs for them to bring about any kind of benefit, static or dynamic. In fact, SEZs, by their very nature, are meant to work as attractive hotspots for foreign direct investments, with them offering tempting packages of business incentives and other preferential conditions. The ability of SEZs to attract FDI inflows is the first sign of their success.

#### ***Employment Creation:***

Aradhna Aggarwal identifies three ways through which SEZs can help in employment creation; 1) direct employment in labor-intensive industries that can admit both skilled and unskilled labor, 2) indirect employment through the services required by the ongoing operations inside SEZs, and 3) women employment with averages higher than

outside the zone as surveys have concluded. (Aggarwal, Impact of Special Economic Zones on Employment, Poverty and Human Development 2007)

Generating job opportunities represents an exceptionally important economic, and rather social, benefit for developing countries that are normally burdened with high rates of unemployment. It is, however, argued that it can take a SEZ 5 to 10 years before reaching the desired levels of employment. (Farole, Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience 2011)

In addition, SEZs are known to offer wages that are relatively higher than those offered outside them.

***Exports Growth:***

A very important benefit of SEZs is their contribution to exports increase. After all, one of the main objectives of SEZs is for them to support an export-led growth strategy. Not to mention that exports represent a good source of foreign exchange earnings.

**B. Dynamic Economic Gains:**

***Local Market Integration and Linkage with Global Value Chains:***

The demand generated by SEZs for local inputs, referred to as backward linkages, is considered to be a crucial indication of success and sustainability. Backward linkage with the local economy are vital to induce technological and skills development. Setting up this linkage is, however, the hardest to achieve, in light of the investors' inclination to rely on their own imports of intermediate goods that they are more comfortable with. In fact, the underdeveloped status of supply chains in many developing countries makes it even impossible for such backward linkages to emerge.

It is also through linkages with the domestic economy that SEZs are able to provide access to global value chains (GVC), particularly in light of their key role in the global phenomenon of "production fragmentation. Production fragmentation refers to the

process of disintegrating production of final goods into phases, with each phase taking place in a different location, primarily in pursuit of best cost conditions, to eventually bring down the total cost of production. In that sense, labor-intensive phases of production are better relocated to countries of low-cost labor. Through the SEZ modality, production fragmentation becomes much more convenient in light of the flexible regulation of capital mobility. (Warr and Menon 2015)

It is, however, important to note that a manufacturer's decision to allocate particular phases of the production process to certain countries may change over time. The changing economic conditions of a certain country may take away the favorable cost conditions that it enjoyed beforehand, rendering it less profitable for manufacturers. This is particularly true in China. As a result of the intense rates of industrialization, China can no longer offer a suitable base for labor-intensive production, with the significant increase in the level of wages. In fact, China's tendency to open up SEZs in less developed countries emerges from a need to relocate the labor-intensive phase of production to locations offering less labor cost. (Warr and Menon 2015)

***Export Diversification:***

One important aspect of the structural transformation associated with the economic development process is to allow countries to, gradually, shift from producing "poor-country" goods to "rich-country" goods, by means of export diversification. Export diversification tend to liberate more importantly commodity-dependent economies with tight export basket from the hazards and instabilities resulting from the inelastic, turbulent global demand, which adds to the volatility of market prices of goods and services. (Hesse 2009)

Furthermore, export diversification implies a expanding the pool of exports away from primary goods and more in the direction of manufactured goods to secure foreign exchange necessary for sustainable growth, in light of the unfavorable pricing conditions of primary commodities. (Chenery 1979)

SEZs contribution to export diversification builds on their ability to attract investments in production of manufactured goods. This is especially significant for underdeveloped, resource-based economies. Besides, SEZs encourage the diversification of the local economy through creating demand for intermediate goods that can be manufactured domestically. (Aggarwal, Hoppe and Walkenhorst, Special Economic Zones and Economic Diversification: Some Evidence from South Asia 2009)

***Skills Development and Technology Transfer:***

SEZs offer a good opportunity for skills development through specialized training and on-job “learning-by-doing” opportunities, especially that foreign investments usually bring along a more advanced organizational and managerial systems. Training courses are, sometimes, held in firms’ headquarters, allowing for further exposure. In few cases, SEZs established technical and vocational institutes that provides for tailored programs that feeds in the needs of the zone. The development of skills within the borders of the SEZ is supposed to be transferred to domestic firms through backward linkages. (Aggarwal, Impact of Special Economic Zones on Employment, Poverty and Human Development 2007)

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***Concluding Remarks:***

Indeed, Farole, through his approach, was able to establish an all-encompassing framework to assess the impact of SEZs, that equally acknowledges their “limited” short-term static benefits, and also their potential to generate more extensive, long-term dynamic gains, not only for the host country, but also for investors and developers. An exhaustive research on the role of SEZs in economic development will, certainly, find in Farole’s framework the ultimate blueprint for a solid assessment that does not rule out any probable aspect of progress that SEZs can bring about. For that very reason, this dissertation will be following Farole’s outline in its evaluation of China’s overseas SEZs.



## Chapter II

### China's Domestic SEZs:

#### Benchmarks for China's Overseas SEZs

Recently, the reputation of China's SEZs has skyrocketed in serving as a catalyst for enhancing economic development through export-oriented industrialization. In fact, the high expectations that governments of developing countries hosting China's overseas SEZs have been largely attributed to the amazing performance of China's domestic SEZs. Hence, it would be natural to see the emerging overseas SEZs brought into comparison with China's own SEZs that have grown over time since late 1970s. For that purpose, this chapter aims to bring China's domestic SEZs under the spotlight to derive some indicators and conditions of success and lesson learned to provide for a framework for evaluation of China's overseas SEZs. Even though setting both groups of SEZs in comparison can be somewhat unfair, given the different political, socioeconomic and geographical contexts, extracting a number of benchmarks of success from China's domestic SEZs can guide the paths of overseas SEZ. This is particularly plausible because China's inclination to assist developing countries develop their SEZs is inspired by the accomplishments of the same model of SEZs domestically. Additionally, it is expected that China's program of overseas SEZs involve transfer of China's knowledge and expertise developed over years in the area of developing and operating SEZs.

#### *1. Background on China's Domestic SEZs:*

Despite the renowned performance of China's SEZs, it is worth noting that the SEZ modality as a stimulus for economic growth is hardly a Chinese invention. By the time China had its first four SEZs set up, other East Asian countries, like Hong Kong, Singapore and South Korea, were already reaping the fruits of their operational SEZs and EPZs. In fact, China's resolution to develop SEZs was influenced by the performance of SEZs in these countries. Nevertheless, it looks like the Chinese version of SEZs turned out later

on to be by far the most popular amongst the developing countries, in light of their incredible contribution to the Chinese economy.

Initially, SEZs in China were launched, towards the end of 1970s, to serve as experimental laboratories to test the viability of the Open Door, market-oriented reforms in a restricted environment before applying them on the national level. For Deng Xiaoping, China's revolutionary leader, SEZs represent the phase of "touching the stones" before "crossing the river" stage from the traditional planned economy to modernized market economy. (Hao 1996) Along this exploratory function, the SEZs China has opened up a window to allow in foreign investment that would bring with it advanced technologies and know-how, and will also offer an abundance of job opportunities.

Some have referred to China's initial SEZs as playing the role of "four windows" and "two sectors." "By four 'windows' are meant 'technology window', 'management window', 'knowledge window', and 'open policy window'... The pivot of the two 'sectors' implies that the special zones act as a linking pivot for the two 'sectors' of external and internal economic intercourse." (Guoguang, Wensen and Liren 1987)

In July 1979, Guangdong and Fujian, in the southeastern coastal region, were selected to host the first four SEZs to spearhead the testing of the new policies and institutions. The four pioneering zones were set up in Shenzhen, Zhuhai and Shantou in Guangdong province and Xiamen in Fujian.

The selection of Guangdong and Fujian provinces to host the first SEZs in China came to satisfy several preconditions. First, there was a need to have this new pilot strategy take place far from the capital to enjoy as much freedom as possible to be able to experiment with the different market-oriented policies. In addition, the location of both provinces allowed them to engage with the outside world, especially through the nearby territories of Hong Kong, Taiwan and Macao. (Zeng, How Do Special Economic Zones and Industrial Clusters Drive China's Rapid Development? 2011) At that time, the proximity to Hong Kong and Taiwan seemed to serve China's political endeavors of

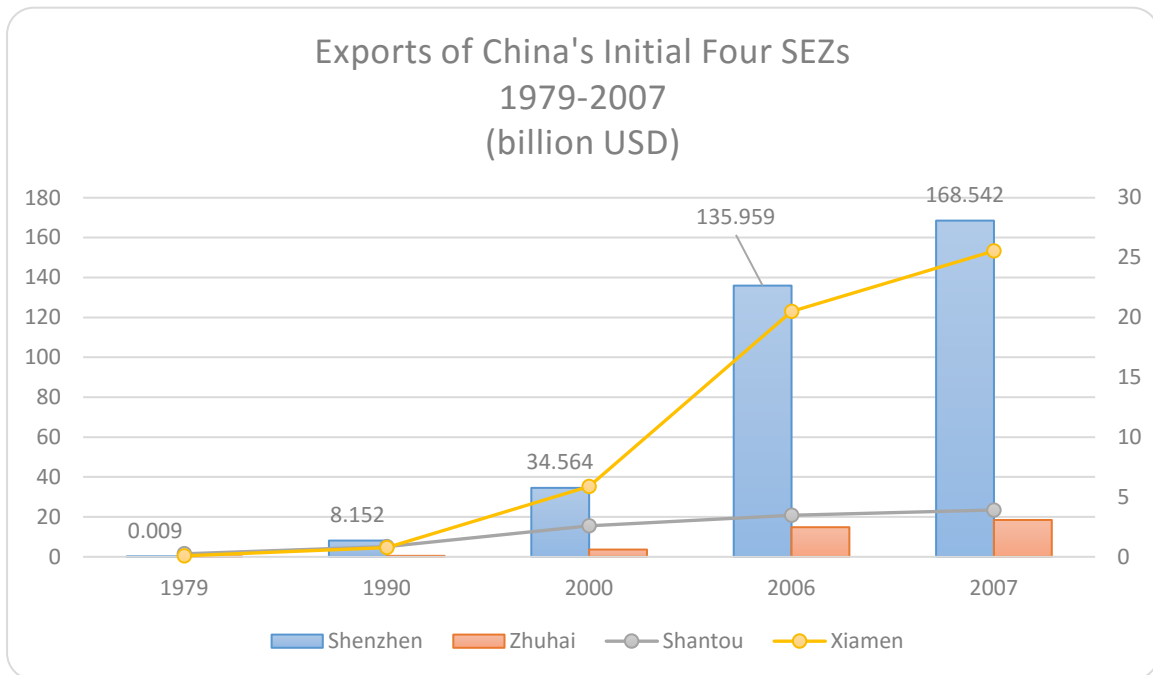
integrating both territories to its mainland, through setting up zones of temptation across the borderlines. Moreover, Guangdong and Fujian provinces were relatively young and underdeveloped compared to the more industrialized cities of Shanghai and Liaoning and this experiment, if failed, would do them little harm.

To enable the four zones accomplish their purpose and to prompt investors' confidence, a set of legislations has been produced to institute the special conditions. Of these legislations, "the Regulations on Special Economic Zones in Guangdong Province" of 26 August 1980 was the most remarkable, being the first of its kind in China. These regulations served as reference for similar areas later on. The regulations of Guangdong were especially unusual in that it invited almost all sorts of foreign investment in almost all sectors, including investment in infrastructural development. This in part reflected the Chinese government's inability to finance the development of the SEZs. (Fenwick 1984) Since the very beginning, China's four pilot SEZs similar conditions of special treatment in financial, investment and trade-related privileges.

Much of China's miraculous economic growth has been attributed to the successes of its first four SEZs. In 1981, the four SEZs harbored 59.8 percent of China's total FDI. Shenzhen alone accounted for 50 percent of total FDI inflows. Even after the gradual opening up of the Chinese economy in later years, these four zones were still able to embrace 20 percent of total FDI in 1985, amounting to US\$ 1.17 billion. (Wong 1987) In 1988, another full-sized SEZ was established in Hainan province. In light of this performance, the Chinese government decided to establish some mini-SEZs labeled Economic and Technological Development Zones (ETDZs) or Industrial Parks. By 1988, 14 of the ETDZs were established along China's coastline in the cities of Tianjin, Dalian, Qinhuangdao, Qingdao, Yantai amongst others. (Leong 2013) This number has multiplied over time, with new ETDZs rising not only in coastal cities, but also deep inside China's mainland. This trend has been further boosted by Deng Xiaoping's famous visit to Southern China in 1992. The visit has promoted the joining of another 23 cities to the SEZ/ETDZs club. In 2010, China's ETDZs increased to 69. (Leong 2013)

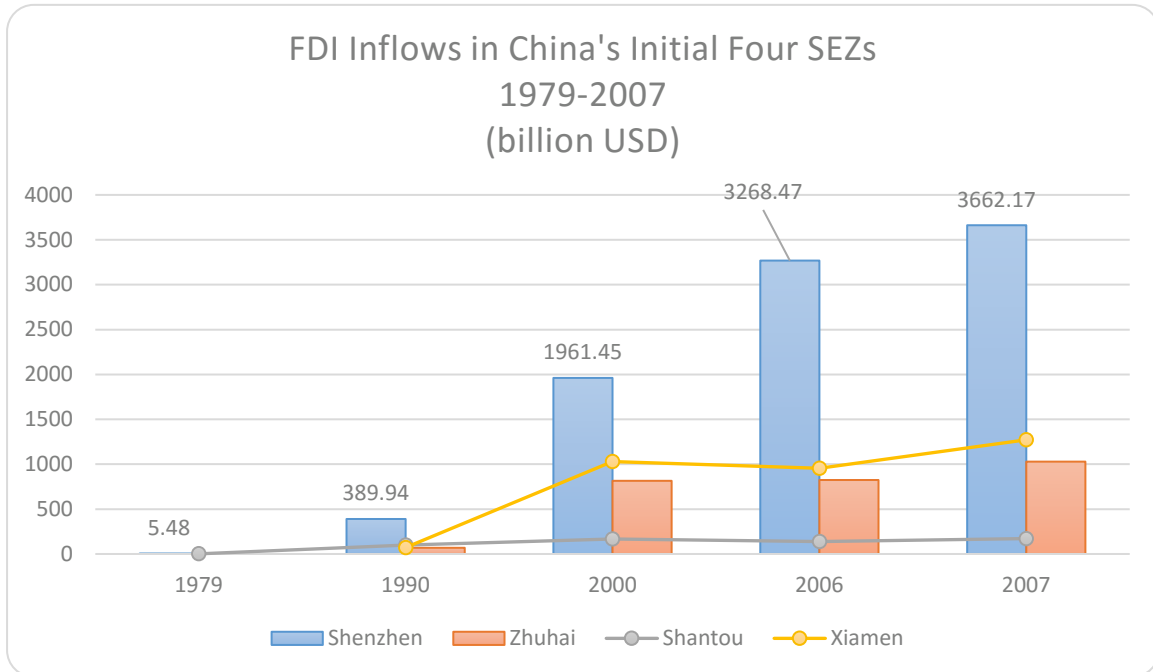
A recent estimate sets SEZs' contribution to the Chinese economy at 22 percent of the China's overall GDP, taking hold of almost 46 percent of the country's inflows of FDI and 60 percent of total exports, while providing for more than 30 million jobs. (Zeng, Global Experiences with Special Economic Zones with a Focus on China and Africa 2015) The two following figures provide a more detailed illustration of how the four SEZ have been positively catalyzing the Chinese economy.

Figure 4



(Yeung, Lee and Kee 2009)

Figure 5



(Yeung, Lee and Kee 2009)

Furthermore, it is worth noting that the multi-sector, comprehensive SEZ modality implemented in the four pioneering zones has inspired several spin-off modalities of special zones, each with a specific strategy and targeting specific sectors. (Zeng, How Do Special Economic Zones and Industrial Clusters Drive China's Rapid Development? 2011)

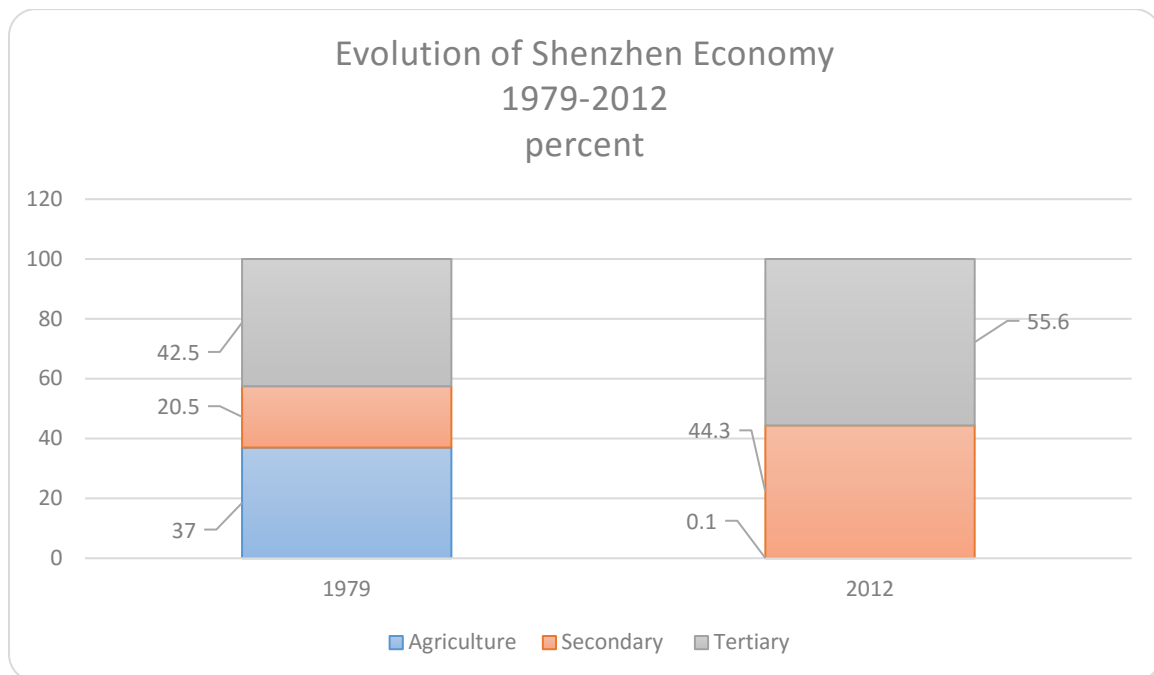
The performance of China's domestic SEZs have collectively resulted in the outstanding economic prosperity of the country. However, Shenzhen is by far the perfect example every emerging SEZ should be looking up to.

## II. Shenzhen, the Benchmark of Successful SEZ:

"Old Shenzhen was a small backward township near the border with urban Hong Kong. It was only 3 km<sup>2</sup> in area and had a population of less than 30,000. Life was hard and the standard of living was low. A large number of people migrated to Hong Kong, leaving large areas of fenlands unattended." (Hao 1996)

Now, Shenzhen has stretched over to occupy an area of almost 2000 km<sup>2</sup> with a population of more than 10 million. This demographic burst merely reflects the phenomenal economic transformation that the little city of Shenzhen has witnessed over time since late 1970s, abandoning the traditional practice of agriculture and totally embracing manufacturing and service-related activities. (see Figure 6) Largely because of the expansion in the secondary industrial sector that Shenzhen was able to grow by 58 percent between 1980 and 1984. More specifically, the special attention that was given to labor-intensive, light manufacturing and high technology industries constitutes a major key element that contributed to the success story of Shenzhen. In this context, it is normal to see a handful of the world's leading high-tech companies, like Foxconn, Huawei, ZTE headquartered in Shenzhen. (H. Yeung 2015) Shenzhen has also been altering the scene in the service sectors of logistics and finance, thanks to its remarkable location.

Figure (6)

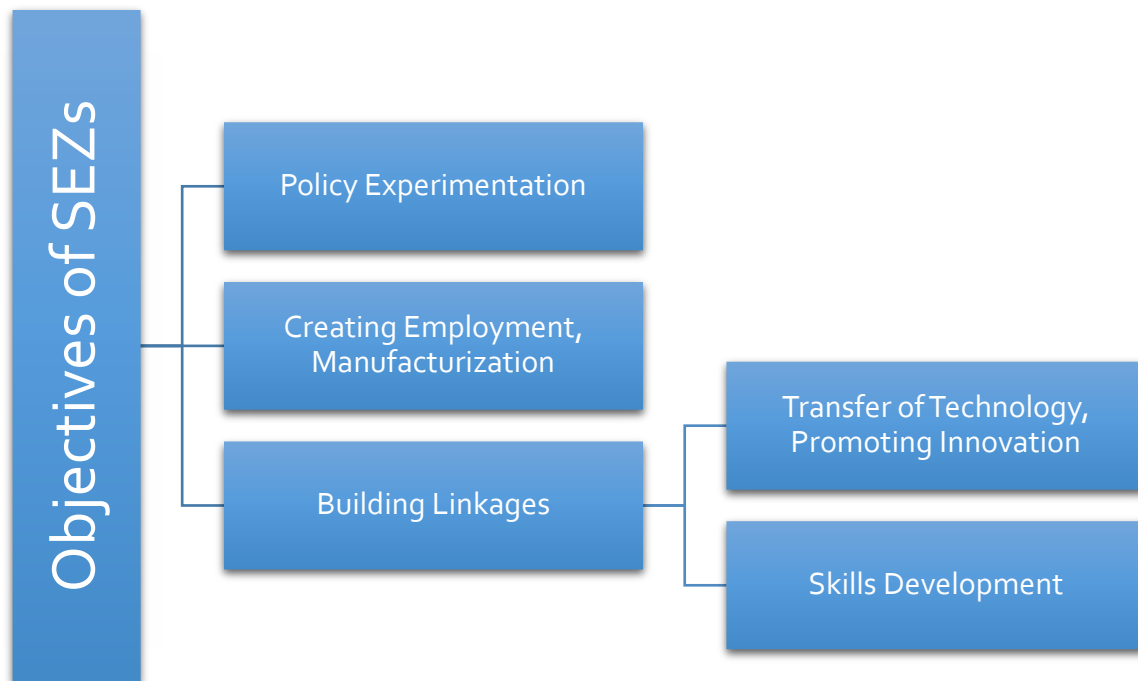


Source: (H. Yeung 2015)

## Objectives:

Building on Deng Xiaoping’s four-windows outlook to SEZs, a number of objectives has been set, along which the performance of China’s SEZs has been gauged. Indicators have been especially derived from these objectives to guide the path of the SEZs and to maintain close monitoring of any deviation. Being the largest of the four initial SEZs and holding the highest of expectations, Shenzhen SEZ has been regularly reviewed in light of such objectives. These objectives are summarized in the following figure.

*Figure 7*



Source: (Brautigam & Tang, “Going Global in Groups”: Structural Transformation and China’s Special Economic Zones Overseas, 2013)

## Legal and Institutional Framework:

As mentioned, Shenzhen SEZ was administered through “the Regulations on Special Economic Zones in Guangdong Province” issued in 1980. Contained in a document of 6 chapters and 26 articles, these regulations were intended to set Shenzhen and the other

two neighboring SEZs on the map of foreign investment. In fact, the regulations did introduce a handful of provisions that were totally alien to China's closed economy. Guangdong's regulations started off with a warm invitation for foreign investors and overseas Chinese and "compatriots" from Hong Kong and Macao, pledging protection of investor's assets, profits and interests. The regulations specified a separate chapter, Chapter 3, to demonstrate the different preferential arrangements offered to investors, the most important of which are exempting the production goods from import duties, the 15 percent corporate income tax, and the further exemption on income tax in the case reinvesting profit in the zone.

The regulations of Guangdong were especially alluring because of three main factors:

- 1) The nonexistence of any requirement on foreign equity within in the Guangdong SEZs, inviting in all kinds of capital,
- 2) The unconventional degree of autonomy that was especially offered to Shenzhen and Zhuhai acceding foreign investment in their respective SEZs, and
- 3) The treatment of labor in accordance with free market regulations.

Nevertheless, it is worth mentioning that the Guangdong's regulations were cautious enough to include articles that emphasize the central government's sovereignty and overall control over the three SEZs. This was especially explicit through Article 3 that established the Guangdong Provincial Committee for the Administration of Special Economic Zones to replace the provincial government and exercise several authoritative roles, particularly in registering new projects.



## The Regulations on Special Economic Zones in Guangdong Province

### General Provisions:

- The special zones shall encourage foreign citizens, overseas Chinese, compatriots from Hong Kong and Macao and their companies and enterprises to open factories and set up enterprises and other establishments with their own investment or in joint ventures with our side, and shall protect their assets, the profits due them and their other lawful rights and interests in accordance with the law. *(Article 1)*
- A Guangdong Provincial Committee for the Administration of Special Economic Zones shall be set up to exercise unified administration of the special zones on behalf of the Guangdong Provincial People's Government. *(Article 3)*

### Registration and Operation:

- Investors may operate their enterprises independently in the special zones and employ foreign personnel for technical and managerial work. *(Article 10)*

### Preferential Treatment:

- The land to be used by investors shall be provided according to actual needs, and preferential treatment shall be given with respect to the duration of its use, the amount of the use fee and the method of payment according to the different types of business and uses. *(Article 12)*
- The machinery and equipment, spare parts, raw and semi-processed materials, means of transportation and other capital goods necessary for production that are imported by enterprises in the special zones shall be exempted from import duties. *(Article 13)*
- The enterprise income tax rate in the special zones is 15 percent. Special preferential treatment shall be given to enterprises established within two years of the promulgation of these Regulations, to enterprises with an investment US\$ 5 million or more, and to enterprises involving higher technology or having a longer period of capital turnover. *(Article 14)*
- Entry and exit procedures shall be simplified and conveniences given to the foreign personnel, overseas Chinese and compatriots from Hong Kong and Macao entering and leaving the special zones. *(Article 18)*

**Invalid source specified.**

Land ownership has been amongst the issue that was left ambiguous in the 1980 regulations. While preferential treatment is highlighted, the article did not specify

exactly how would land be provided to investors, only referring to separate provisions in this regard.

### **Early-years Performance**

Against the objectives China had when it launched its SEZs initiative and through Farole's framework for assessing SEZs' role and impact, Shenzhen has turned out to be quite a performer.

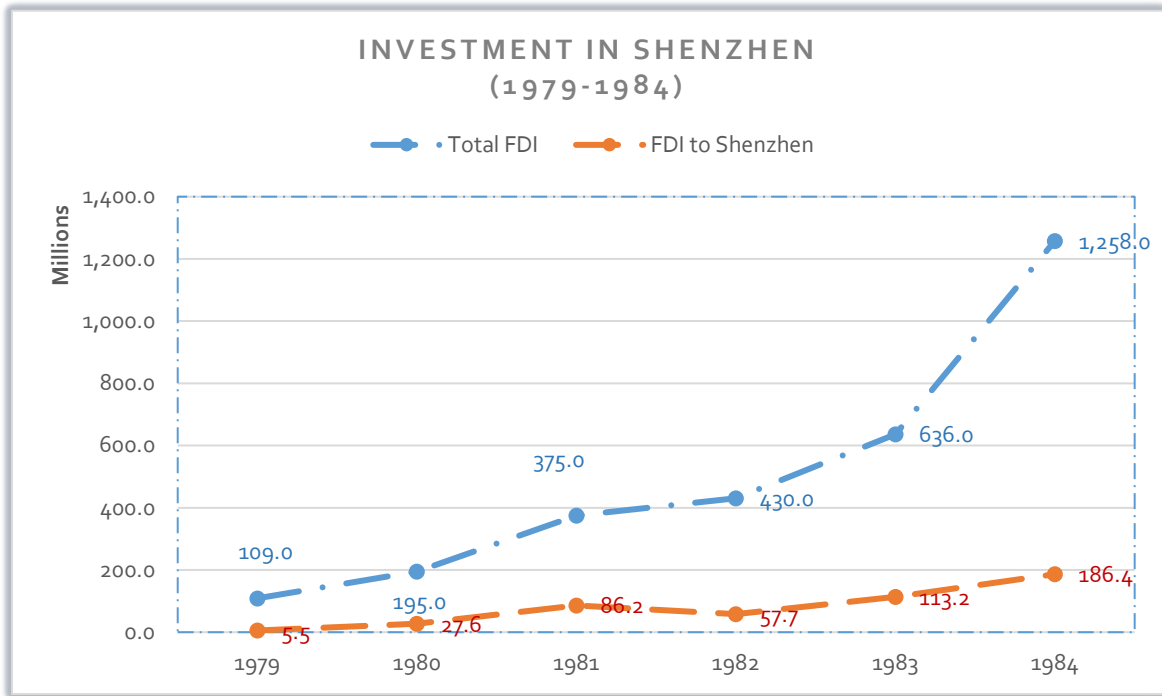
#### **A. Static Economic Gains:**

##### **1) Volume of Foreign Direct Investment**

In the period from 1979-1984, Shenzhen's outstanding performance was translated in 3,319 contracts that accounted for USD 2.3 billion and a total production of USD 1 billion. (Chu 1987) Even though actual investments settled for less amounts than committed through the signed contracts, Shenzhen's net FDI inflows sustained an upward inclination, with inflows growing steadily over the years, as shown in the following figure. Likewise, the contribution of Shenzhen's FDI inflows to the total size of FDI inflows to China has enlarged significantly in the years following its outset. Starting off with only 5 percent in 1979, Shenzhen was able to increase its share of China's national FDI inflows to more than 14 percent in 1984.

The very same figure, however, indicates that the dramatic leaps in the national figures of FDI inflows to China have been less and less associated to the increase in Shenzhen's FDI inflows. This implies that Shenzhen constituted only one of the hotspots that were meant to attract FDI, as part of the overarching "Open-Door" policy.

Figure 8



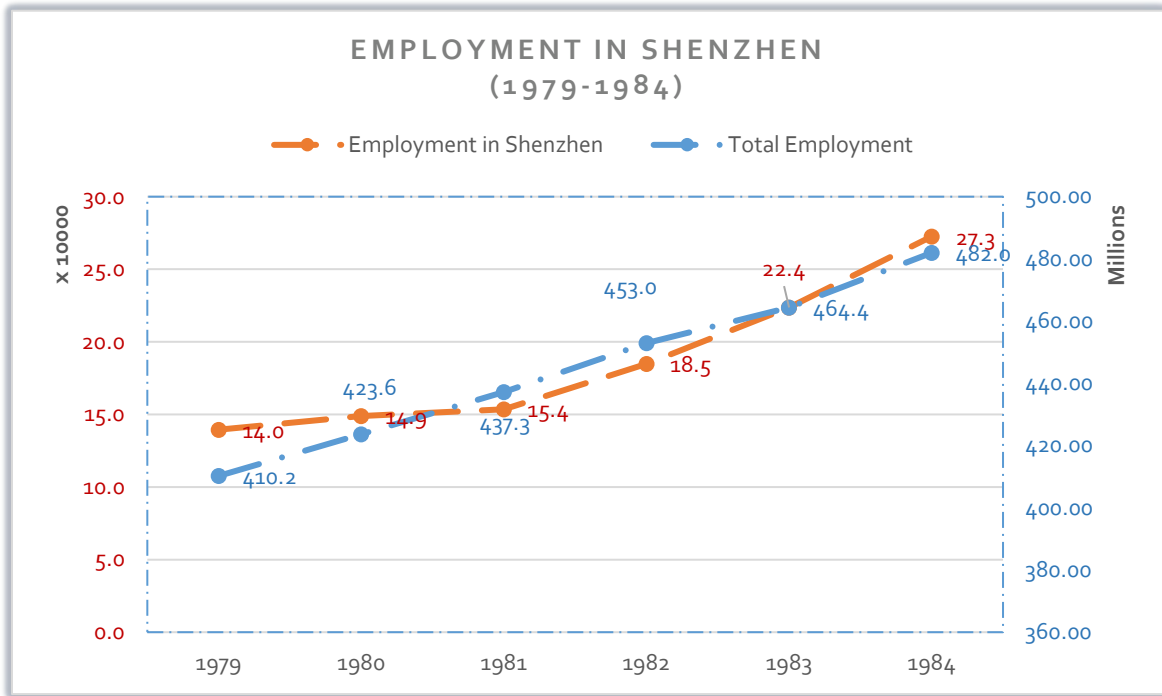
(Shenzhen Statistical Bureau 2015) (The World Bank Group 2016) (Chen, Chang and Zhang 1995)

## 2) Employment Creation

Although Shenzhen's ability to secure employment opportunities has grown gradually year after year with promising rates, reaching up to 272,600 employed persons in 1984, Shenzhen's share of total employment 0.05 percent. In 2014, the number of employed people in Shenzhen jumped to about 8,996,600, yet still accounting for 1 percent of total employment in China.

In 1981, Shenzhen workers earned an average monthly net wage ranging from USD45 to USD67, an amount that was three times the average monthly wage of workers outside Shenzhen. (Chu 1987)

Figure 9

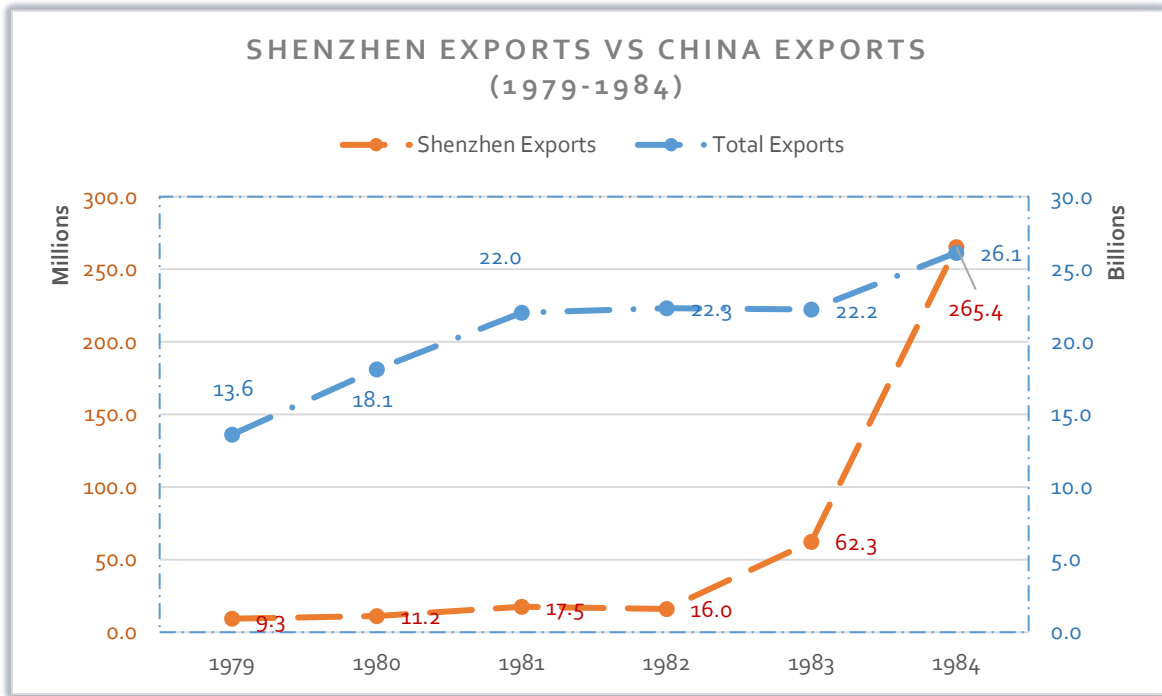


(Shenzhen Statistical Bureau 2015) (People's Republic of China 2015)

### 3) Volume of Exports

As demonstrated in the figure below, it took Shenzhen four years before being able to have a significant contribution to the total exports of China. Up to 1983, Shenzhen exports roved around the 0.07 percent. In 1983, Shenzhen share picked up to constitute 0.2 percent of total exports before leaping in 1984 to make up 1 percent.

Figure 10



(Shenzhen Statistical Bureau 2015) (The World Bank Group 2016)

## B. Dynamic Economic Gains:

### 1) Local Market Integration and Linkage with Global Value Chains:

Shenzhen, just as other SEZs, has shown special yearning for high-technology investments, providing more incentives and privileges for hi-tech firms, with an aim to provide for a conducive environment for technology transfer. But in order to ensure establishing linkages with domestic economy, local producers were encouraged to join the SEZ framework to scale up and be able to fit in with the supply chain of foreign high-technology producers. (Schrank 2001)

On a related note, the exposure of Shenzhen's labor to a more sophisticated and more advanced work environment, particularly through the joint-venture modality has certainly contributed to the development of their managerial and technical skills.

## **2) Export Diversification:**

To achieve industrial and export diversification, Shenzhen has systematically and gradually gone through three major stages. It all started with labor-intensive, but modern, small-scale industries, before upgrading, in the second stage, to high-technology manufacturing. The third stage of diversification has seen the embracing of top-notch technologies and scientific-based manufacturing. (Tantri 2011)

### ***III. China's SEZs Elements of Success:***

After 26 years of unceasing growth and undeniable contribution to the advancement and evolution of the Chinese economy, Shenzhen and its fellow members of China's club of SEZs managed to set themselves as models of success, triggering considerable amounts of attention, particularly in the economic development field of study. Out of the many aspects of China's SEZs experience, and most importantly of Shenzhen's, the question of "how did they manage to do it?" comes at the center. In answering this question, the literature on China's domestic SEZs tend to agree on several factors that have served as elements of success.

#### **Strong Governmental Commitment and Support:**

The success of Shenzhen, and more generally China's experience with SEZs, is largely attributed to the determination and persistence of the Chinese government to introduce market-oriented reforms necessary to achieve economic rejuvenation. This determination was coupled with a pragmatic approach that signaled an absolute divorce from China's long adherence and fidelity to the principles and mechanisms of the planned economy, turning a blind eye, at least partially, to the Cold-War-related political discourse. China's pragmatism is perfectly depicted through Deng Xiaoping's statement that "No matter if it is a white cat or a black cat. As long as it can catch mice, it is a good cat." (Zeng 2011) In addition to pragmatism, the Chinese government was smart enough to take on a gradualist approach in implementing the SEZ strategy.

Either centrally or on the provincial level, government support also shows in its commitment to extend necessary infrastructure and to make available all conditions that would provide for a conducive environment for investment.

#### **The Perfect Package of Preferential Policies:**

It can be argued that offering the right blend of incentives to investors, particularly foreign investors, is what a SEZ is all about. For China's SEZs, setting up an attractive package of incentives was not a one-day task. Although Guangdong regulations brought about a decent set of preferential policies, further inducements were required to gain the trust of investors amid skepticism towards China's commitment to pledged market-oriented reforms.

#### **Delegating Aspects of Autonomy:**

Considered a vital factor for SEZs to attract foreign investment, the greater the autonomy a SEZ administration enjoy, the larger its capacity to offer reassurances for incoming investors. SEZs of China were allowed significant legislative powers to introduce whatever regulations they find necessary to enhance their performance. For example, in order to bring in qualified personnel many of China's SEZs were able to set up their separate market-based labor laws. In fact, a great deal of Shenzhen's success has been attributed to the innovative regulatory frameworks it managed to set forth, thanks to the legislative free-hand it assumed, after being granted the political status of a province in 1988. Among Shenzhen's legislative innovations were the unprecedented wage reforms and the 24-hour government approval system. (Zeng, How Do Special Economic Zones and Industrial Clusters Drive China's Rapid Development? 2011)

#### **Inviting Relevant International Expertise:**

As pointed out, the SEZ scheme was never a Chinese creation. In fact, this modality has developed centuries before it was adopted by China along its opening up policies in the late 1970s. In fact, China, on setting the first steps in this direction, sought external assistance from regional partners who happened to have the expertise at that point of

time. One example was having the Japanese government contribute to the sketching of the masterplan of the Qingdao port back in 1983. In the early 1990s, The Japanese International Cooperation Agency (JICA) provided funds to support the building up of necessary infrastructure of the Qingdao zone.

China has also learned from the Singaporean model in developing SEZs, particularly in the cities of Wuxi and Suzhou, within the Jiangsu province, where partners from Singapore came together with the Chinese under joint-venture arrangements to launch special industrial parks in the years 1993 and 1994. Surprisingly, the Singaporeans were the ones who took the lead in managing the two zones, before the Chinese assumed the majority of shares and acquired the decision-making status in early 2000s. (Brautigam & Tang, China's Investment in Special Economic Zones in Africa, 2011) The tendency of China to benefit from international experiences, even after it has developed a renowned reputation in developing and managing SEZs, showed how the opened and pragmatic the Chinese government was vis-à-vis new successful techniques that could add thrust to the already-booming momentum.

#### **Nurturing Innovation:**

Since the very beginning, there was an intention to make China's SEZs hubs of innovation and technology. This was fairly guaranteed as long as foreign investments were flowing in with their new technologies. Nonetheless, SEZs themselves provided mechanisms that did cultivate cultures of innovation. In Shenzhen, serious regulations were put in to protect intellectual property rights. Also, the belief in innovation has made Tianjin Economic Technological Development Area (TEDA) to invite universities to open campuses within the zone, to provide vocational training and to enhance research and development.

#### **Advantageous Location:**

Many of China's SEZs exist on the eastern and southern coastal region, served by several ports and extensive networks of railroads, allowing them channels of communication



with international domestic markets. The location advantage has also helped SEZs to become logistical hubs, providing a wide range of financial and non-financial services.

#### **“Chinese Diaspora” Advantage:**

During their early stages, China’s SEZs were heavily sustained by the FDI flows generated by the Chinese diaspora, particularly in Hong Kong, Taiwan and Macao. Three factors contributed to this trend. First, Hong Kong, Taiwan and Macao have seen in China’s SEZ the perfect destination to transfer their labor-intensive manufacturing activities, allowing them more room to render their industries more technology-intensive. Secondly, the incentives offered by China’s SEZs seemed competitive to those prevalent in either of these territories. Thirdly, factors of culture, common language and proximity have played a significant role in forcing FDI into China’s newly-established SEZs. (Zeng, How Do Special Economic Zones and Industrial Clusters Drive China’s Rapid Development? 2011)

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#### ***Concluding Remarks:***

Several elements have enabled China’s domestic SEZ realize their objectives and contribute to the revitalization of China’s economy. The amazing performance these SEZs has brought about, especially in Shenzhen, qualifies them to serve as handbooks for other emerging SEZs. In that sense, the performance of China’s domestic SEZs presented through the benefits realized with Farole’s framework, and represented by Shenzhen, can function as indicators of progress/ failure on evaluating the China’s newly established overseas SEZs. The following chapter will be reviewing the performance of China’s overseas SEZs using a framework of evaluation combining Farole’s framework for assessing SEZs impact with indicative data from Shenzhen’s experience.

## **Part Two**

### **Evaluation of China's Overseas SEZs**

Part One of this dissertation has established a framework for evaluating the performance of China's overseas SEZs, by looking at the benefits they were able realize thus far. The ultimate objective of this evaluation is to determine whether China's model of SEZs can yield satisfying outcomes, and can be replicated in other less developed countries. For that purpose, this part of the dissertation is intended to put China's overseas SEZs under close examination by comparing them to China's own experience with domestic SEZs, through Farole's static-versus-dynamic benefits framework. In this context, Chapter I of this part will be first introducing China's program of overseas SEZs, before proceeding with the assessment in Chapter II.

## Chapter I

### China's Overseas SEZs: A Contextual Background

This chapter will be exploring the China's intriguing program of establishing SEZs in some developing countries of the global South, with an aim to introduce the Chinese initiative that, primarily, qualifies as an act of development assistance.

#### *I. China's Overseas SEZs Program: Background:*

Among the different modalities of China's South-South development financing, the program on overseas special economic zones is the most unconventional. Since the launching of its "Going Global" strategy, China has supported its firms to stretch overseas, open new markets and extend their investments abroad. The business element is hard to miss in China's overseas SEZs. Surprisingly, however, this initiative has spearheaded Chinese external assistance in recent years. China's very first overseas SEZs were launched in 2000, as pilot projects. China's initial involvement of this kind was in Camden, South Carolina, United States of America, where Haier<sup>2</sup> established a 100-acre industrial park that was inaugurated in 2000. (Haier 2014) Even before that, in 1999, an agreement between China and Egypt was signed to set up an economic zone in Suez. Later in 2003, similar arrangements were put in place in Zambia. Yet, it was only under the "Going Global" strategy that this modality made it to China's policy agenda. Specifically, in 2006, the Chinese government announced its long-term plan to develop up to fifty overseas economic and trade cooperation zones. Several developing countries were selected to host the first batch of China's overseas SEZs. (The World Bank 2011)

Thus far, Chinese SEZs remain in an embryonic stage. Nevertheless, by 2010, of the 19 SEZ proposals, MOFCOM reported that 16 of the SEZs were under construction. These

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<sup>2</sup> One of the leading household appliance companies.

involved more than 200 companies and investments of USD 2.5 billion. (The World Bank 2011)

Profit is the main driver and foundation of Chinese overseas SEZs. Profit generated by companies investing in these zones tend to be the assurance for the sustainability of the program, and hence its significance for the host country and China. For that purpose, the Chinese government, while submitting to market forces, brings in a package of financial and non-financial incentives to stimulate Chinese companies to divert their investments to developing countries, investments that would otherwise be directed to far more reliable, less volatile and cost-effective locations. In that sense, MOFCOM’s package of incentives constitute the concessional or assistance element provided by China to hosting countries.

*Table 1*

**China’s Tendered Overseas SEZs**

<b>Region/Country</b>	<b>Zone</b>	<b>Year of Tender</b>
<i>North Africa</i>		
<b>Algeria</b>	<b>Chinese Jiangling Economic and Trade Cooperation Zone</b>	<b>2007</b>
<b>Egypt</b>	<b>Tianjin TEDA Suez Economic and Trade Cooperation Zone</b>	<b>2007</b>
<i>Sub-Saharan Africa</i>		
<b>Ethiopia</b>	<b>Eastern/Orient Industrial Park, Jiangsu Qiyaan Investment</b>	<b>2007</b>
<b>Mauritius</b>	<b>Tianli (now JinFei) Economic and Trade Cooperation Zone</b>	<b>2006</b>
<b>Nigeria</b>	<b>Guangdong Ogun Economic and Trade Cooperation Zone</b>	<b>2006</b>
	<b>Lekki Free Trade Zone</b>	<b>2007</b>
<b>Zambia</b>	<b>Chambishi Nonferrous Metal Mining Group Industrial Park</b>	<b>2006</b>

Region/Country	Zone	Year of Tender
<i>East Asia</i>		
Cambodia	Taihu International Economic Cooperation Zone, Sihanouk	2006
Indonesia	Chinese Guangxi Economic and Trade Cooperation Zone	2007
South Korea	The Saemangeum Gunsan Free Economic Zone	2007
Thailand	Luoyong Industrial Zone	2006
Vietnam	Chinese (Shenzhen) Economic and Trade Cooperation Zone	2007
	Longjiang Economic and Trade Cooperation Zone	2007
<i>South Asia</i>		
Pakistan	Haier-Ruba Home Appliance Industrial Zone	2006
<i>Latin America</i>		
Mexico	Ningbo Geely Industrial Economic and Trade Cooperation Zone	2007
Venezuela	Lacua Tech and Industrial Trade Zone	2007
<i>Eastern Europe</i>		
Russian Federation	St. Peterburg Baltic Economic and Trade Cooperation Zone	2006
	Ussuriysk Economic and Trade Cooperation Zone	2006
	Tomsk Siberia Industrial and Trade Cooperation Zone	2007

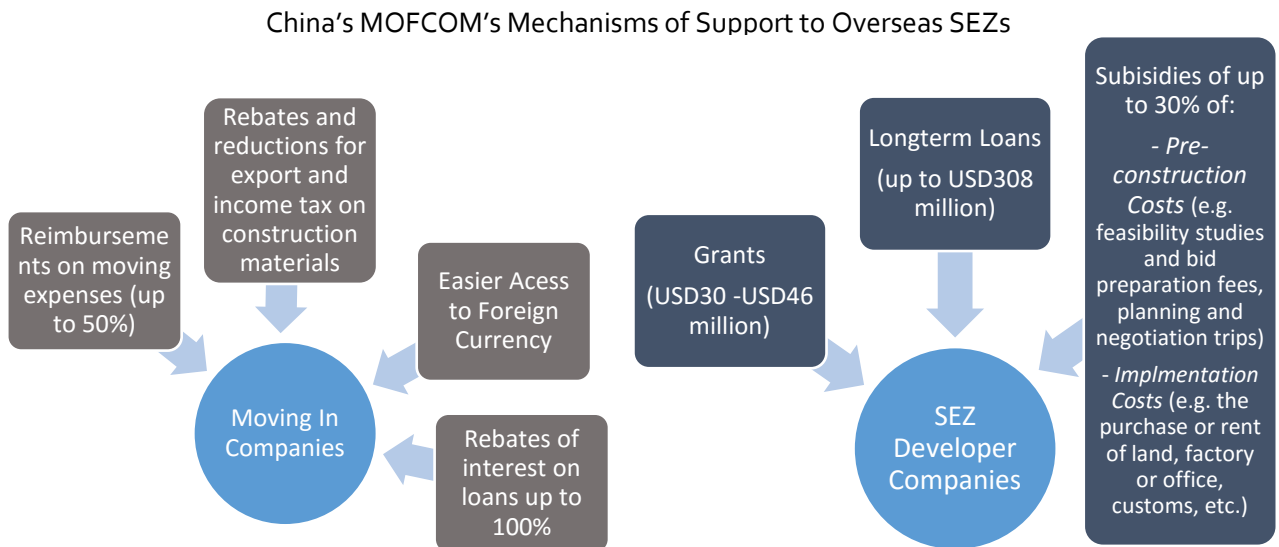
Source: (Brautigam 2011)

## *II. China's Overseas SEZ as a Development Assistance Initiative*

Unlike the more straightforward modalities like grants, the concessional component in China's overseas SEZs can be hard to identify at first glance. Certainly, they fit as foreign direct investment (FDI) inflows to recipient countries. However, with the Chinese government pledging support for Chinese companies investing in overseas SEZs through different sets of incentives, the margin of risk associated with such investments

becomes much lower. A wide range of financial and non-financial incentives, at times called “strategic lines of credit,” is offered by the Chinese government for that purpose. (Brautigam 2011) For instance, Chinese companies working on zones development are eligible for grants, loans and rebates on interests, in addition to subsidies that may cover up to 30 percent of preconstruction and implementation costs. Diplomatic backing is another form of support provided by the Chinese government. Companies moving in one of China’s overseas SEZs are also offered similar package of incentives. They may be entitled to refunds for up to half of their “moving in” expenses, in addition to export credits on construction materials. (World Bank January 2011)

Figure 11



Source: (Brautigam 2011)

Hence, from a business perspective, this package of incentives renders China-sponsored overseas SEZs a more attractive option. In that sense, and given the economic and social benefits generated from FDI inflows, it appears that the financial and non-financial support provided to the Chinese companies are translated into indirect gains for hosting countries. In other words, the Chinese government officially supports Chinese overseas investments in developing countries to serve as a more sustainable and efficient form of external assistance.

Furthermore, the Chinese government has been supporting the establishing of overseas SEZ in developing countries through regional financial entities, particularly the China-Africa Development Bank (CADF), which was founded by the Chinese State Council in 2007.

In addition to incentives provided to its overseas companies, the Chinese government has stated, in November 2009, that it will expand the framework of incentives to cover African small and medium-sized enterprises. (Brautigam and Tang 2011)

### *III. China's Overseas SEZs Program: A Win-Win Arrangement?*

As mentioned, it is argued that any form of development assistance would certainly involve particular gains on the side of the assistance provider. In fact, unlike North-South aid flows, China's South-South Cooperation initiatives explicitly admits the element of mutuality of benefit. In the case of China's overseas SEZs, objectives are much easier to identify, and Chinese benefits are simpler to estimate. Through establishing overseas SEZ, 1) Chinese companies will have tangible physical presence in foreign developing countries, an opportunity for their products of goods and equipment to have direct access to new local markets. In Africa, trade flows with China have already been on the rise since 1990s. China's SEZs in Africa will only capitalize on existing cooperation to maximize benefits. Additionally, 2) overseas SEZs will offer Chinese firms the advantage of bypassing trade barriers and restrictions imposed by Europe and United States on China's exports. Moreover, Chinese companies may be eligible privileges associated with third-party arrangements between hosting countries and third countries. In addition, overseas SEZs are intended 3) to support medium and small-sized Chinese enterprises to develop internationally and expand in size.

Nonetheless, these objectives should not overshadow China's desire to share its success story of domestic SEZs with other developing countries.

In fact, evidence, thus far, has confirmed China's multiplicity of objectives as illustrated. In Egypt, companies in China's SEZ tend to assume different production strategies, with each targeting different range of markets. Some companies serve the Egyptian market,

while others produce for the European market, and some other companies work to export back to China. (Brautigam and Tang 2011)

Similarly, from the perspective of hosting countries, China's overseas SEZs represents a tempting venture. In light of the successes of SEZs in China and their ability to induce incredible structural transformation in the Chinese economy, it is easy to get governments in developing countries zealous about the initiative. After all, the business of establishing a SEZ is, by no means, a smooth process. In addition to the large amounts of funds needed to finance the development of SEZ, a substantial load of technical know-how is required to ensure the provision of, at least, the basic elements to render it an attractive spot for investment. And where to go for technical know-how on SEZs if not China, the country of the famous Shenzhen SEZ that transformed a small fishing village into a large and modern metropolis. It is, however, worth noting that establishing SEZs as drivers of industrialization and development is not totally alien for the global South. In fact, some developing countries have had one experience or two of SEZ. Mauritius, for instance, has managed, independently, to set up a SEZ that turned out to be very successful. But Mauritius case poses as an exception in this regard. For that matter, it may be quite beneficial to revisit this modality once again, yet this time with the Chinese model guiding the way.

The World Bank was, especially, enthusiastic about China's initiative to develop overseas SEZs in Africa. In a report published in 2011 titled "Chinese Investments in Special Economic Zones in Africa: Progress, Challenges and Lessons Learned," the World Bank highlighted the many aspects through which the developing countries of Africa can benefit from the Chinese initiative. Primarily, the program serves as a chance for hosting countries to receive technical assistance and to undergo capacity building on "designing a policy, legal, regulatory and institutional framework for the development, management and regulation of zones, as well as on models for public financing and Public-Private Partnership arrangements for external infrastructure for zones." This is actually being accomplished through MOFCOM's sponsored training and technology



transfer centers. Additionally, the initiative, being implemented in various locations over almost all the continents of the South, represents a valuable opportunity of joint learning and knowledge sharing in this regard and along the process of implementation. Exchange of visits between the participating zones can be helpful to compare and borrow successful approaches. The report has also invited the World Bank and its International Finance Corporation (IFC) to be part of this initiative through particular interventions. (The World Bank 2011)

#### ***IV. Framework and Design of China's Overseas SEZ:***

China's program of overseas SEZs work under certain public-private partnership arrangements similar to those endorsed for China's domestic SEZs during 1980s, in which the private sector had a privileged role that was only fine-tuned by the regulatory function of the state and the local government. In that sense, the Chinese overseas initiative seems to be extending the features of the "developmental state" paradigm beyond China's boundaries, adding up to the Chinese economy almost in the same manner as the domestic SEZs.

In the case of China's overseas SEZs, the nature of the public-private partnership can be especially recognized through the following:

##### **A. Preparing of Proposals**

Although the Chinese program of overseas SEZs is propagated as a state-led initiative, the process of developing SEZs is initiated, designed and coordinated by Chinese developer companies. Even negotiations with hosting governments are managed by Chinese companies. The Chinese government, through its MOFCOM only decides to intervene in cases where government-level negotiations are needed to go over treaties that may benefit the work of the zones, like double-taxation and investment protection treaties.

## **B. The Tender Process:**

Instead of passing over the task of developing overseas SEZs to state-owned companies, China found it more appropriate to turn to competitive public bidding. “In order to undertake affair in deed with market regulation, be fair, justice and transparent, MOFCOM adopts measure of bid invitation. Exemplary implementing unit and scheme will be selected through bidding in public.” (People's Republic of China Ministry of Commerce 2006) In this context, two rounds of tenders were held in 2006 and 2007, in which, 110 firms expressed initial interest. The tender committee, composed of SEZs experts and practitioners, ended up asking 32 companies to submit formal proposals, out of which 19 proposals were selected to be funded by the program. The criteria used to evaluate proposals were based on “feasibility studies, the degree to which the firms could document evidence of support from the host government, the developers’ ability to finance the project, and their proven capacity to implement a major construction engineering project. (Brautigam and Tang 2013)

A considerable portion of the winning proposals belonged to some of Chinese national and provincial state-owned enterprises, indicating that the Chinese government had an interest to extend its role beyond the mere overseer to share the benefits of the direct implementer.

## **C. Monitoring and Evaluation:**

An important clue to understanding the nature of the relationship between the Chinese government and its companies is implied in the reporting task that developers are have to commit to. Developers of China’s overseas SEZs are supposed to submit periodical progress reports to MOFCOM. Zones are also subject to receive evaluation missions. Subsidies provided by MOFCOM are actually linked to performance achieved by Chinese companies.

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## ***V. Concluding Remarks***

China's overseas SEZs can be easily confused with normal transnational business arrangements. It is true that the Chinese initiative stems from a profit-oriented business rationale, with Chinese firms serving as the key actors. As matter of fact, the business element in the Chinese program adds to its appeal, rendering it more solid and sustainable. However, China's overseas SEZs serve, primarily, as a form of cooperation, and also as a typical modality of development assistance. Indeed, the Chinese overseas SEZs constitute an element of "concessionality". Ultimately, the Chinese program did manage to render the hosting countries more attractive for the Chinese developers through the generous framework of incentives. Following this logic, it can be viewed that the hosting countries in the South are, indirectly, benefitting from the program through the investments directed to their territories.

## Chapter II

### Assessing the Impact of China's Overseas SEZs

In this context, this chapter will be reviewing China's overseas SEZs in light of Farole's framework, fishing for both, static and dynamic economic benefits. In other words, this chapter will function as a "litmus test" to specify whether or not the overseas zones enclose the very elements that would set them on the path of success, just as the ones that eventually enabled China's to achieve economic miracles. It would be however unfair to judge the young experience of overseas SEZs to the much older, and fully-developed China's SEZs. Therefore, the chapter will be examining the current status of the overseas SEZs using careful qualitative analysis, along with some quantitative tools that would appreciate even the slightest, but promising indications of progress. Three case studies of China's overseas SEZs shall be brought in for in-depth analysis; 1) China-Egypt Suez Economic and Trade Cooperation Zone (SETC Zone), 2) Ethiopia's Eastern Industrial Zone (EIZ) and 3) Zambia-China Economic and Trade Cooperation Zone (ZCCZ).

## I. China's Overseas SEZs: Performance Review

Out of the 19 winning proposals for the Chinese MOFCOM's tender on its overseas SEZs program, 16 proposals managed to show significant progress. Getting the zones started was quite a manageable task in countries with more sophisticated economies like South Korea, Vietnam, Indonesia and Thailand that have benefitted from earlier regional initiatives, mostly launched by Japan. Otherwise, a bumpy take off was expected for the rest of the zones, especially those implemented in Africa.

Two elements, however, were assumed to help China's SEZs of Africa have a smoother kickoff. First, the SEZ concept was not completely new for Africa. Almost all African countries that are currently hosting one or two of China's SEZs have at one point in time experimented with some of the basic forms of SEZs. These experiences hardly showed any sign of success. Nigeria established a number of export-processing zones. Egypt also operates several industrial zones. Perhaps, Mauritius was the only fortunate experience of a well-performing African export-oriented zone with over than 40 years of operation.

Secondly, almost all tender-winning developers have been running businesses within countries where their SEZs are now located. In Zambia, the China Nonferrous Metal Mining Company (CNMC) was working since 1998 on a major copper mine complex in Chambishi area. The proposal of the Chambishi Multi-Facility Zone was presented by CNMC only to utilize the 40 square kilometer surface area of the mine to support the value chain of the mining industry through setting up relevant processing and recycling facilities. Also, China Civil Engineering Construction Corporation (CCECC) has been operational in Nigeria for more than 10 years before joining the Chinese consortium CCECC-Beiya along with other Nigerian companies to launch the Lekki Free Trade Zone (LFTZ) through MOFCOM's 2007 tender. Similarly, before the Tianli Group won the bid to develop Mauritius' JinFei zone, they constituted one of the major suppliers of textile

products in Mauritius. (Brautigam & Tang, China's Investment in Special Economic Zones in Africa, 2011) Definitely, the prior experience some of China's overseas SEZs bidders had in hosting countries provided them with significant advantage on submitting proposals, as they were able to capitalize on their existing business networks and their knowledge about the business environment. By the end of the tender process, it appeared that China's "Going Global" SEZs program was intending to make the best use out of the standing expertise of the Chinese companies already operating in developing countries for the benefit of the program.

It is worth noting that the proposed Chinese overseas SEZs did not subscribe to the standard comprehensive model of SEZs. While most zone went for the comprehensive framework of an Economic and Trade Cooperation Zone (10 out of the 16), other zones were designed as Industrial Parks or Free Trade areas, such as the Eastern Industrial Park in Ethiopia Luoyong Industrial Zone of Thailand.

The management structure was another feature that emphasized the diversity and pragmatism in operating China's overseas SEZs. Almost none of the established SEZs had the same management arrangement. In Ethiopia for instance, the Eastern Industrial zone has been exclusively operated by the Jiangsu Qiyuan Group. Alternatively, most of the zones, like in Nigeria, Egypt and Zambia) are managed through joint venture frameworks with governments of host countries. Another popular management arrangement is the done through consortiums combining a number of Chinese companies. One remarkable feature, however, is that provincial state-owned enterprises were encouraged to participate in managing China's overseas SEZs either through joint ventures or consortiums. (The World Bank 2011)

### ***China's Overseas SEZs: Progress to Date***

Indeed, flexibility and pragmatism will prove to be of magical effect in implementing China's program of overseas SEZs, primarily to accommodate the differences amongst

the hosting countries regarding their political, economic and social conditions. As matter of fact, this very pragmatic approach was vital for the success of China's very own SEZs.

### ***Static Gains: Investment and Job Creation***

The developing phase of construction and setting up proper infrastructure for China's overseas SEZs has proven to be quite overwhelming for both the Chinese developer companies and the governments of the hosting countries, lasting for more than three years in most cases. (Brautigam & Tang, "Going Global in Groups": Structural Transformation and China's Special Economic Zones Overseas, 2013) Up till this moment some of the zones are unable to get past this stage. Responsibility for the prolonged construction stage is shared, given that host governments are supposed to extend the required infrastructure till the borders of the zones, whereas the Chinese developers are the ones liable for on-site infrastructure inside the zones. By June 2010, MOFCOM indicated that an amount of USD 700 million has been invested in the 16 operational zones, mostly to support the construction phase. (The World Bank 2011)

Despite the slow progress, as early as June 2010, China's overseas SEZs managed collectively to gain interest of around 200 companies along with more than USD 2.5 billion of investment commitments. (The World Bank 2011) Currently, the performance of China's 16 overseas SEZs is below the desired targets, yet satisfactory on many fronts. By December 2014, Zambia's Chambishi Multi-Facility Economic Zone managed to bring in 28 companies with investments of more than USD 1.2 billion, generating 8735 employment opportunity with Zambian labor increasing with time relative to the Chinese labor. Revenues accounted for more than USD 7 billion in by the end of 2013. Another promising start has been reported from Lekki Free Zone in Nigeria with 21 firms already operating in the zone through USD 156 million worth of capital investment, offering permanent jobs for more than 550 workers. Even the less fortunate Eastern Industrial Park of Ethiopia, which had to endure some financial difficulties in its very early days, was able, by 2015, to draw in 27 companies with investments of USD 205 million and job opportunities of 4500. (UNDP 2015)

### ***Dynamic Gains: Policy Experimentation and Building Linkages***

Maybe the most important virtue of China's initiative to establish several overseas SEZs is sharing its successful SEZ experience with countries that may have the potential to grow economically but lack the know-how. Getting countries of the global South exposed to SEZ practices through engaging government officials and zone administrators in relevant seminars, study tours and training workshops, part of which were held in zones in China, has definitely contributed to a better understanding of the SEZ concept and its underlying policies. For many, the SEZ concept was unclear. In Ethiopia, for instance, the government confused SEZs with standard industrial zones, and, hence, was reluctant to allow for preferential policies. Only after a number of minister-level visits to China's SEZs that Ethiopia was willing to experiment with the policies of SEZs. (Brautigam and Tang 2013)

Desperate to attract investments of any sort, China's overseas SEZs had to deviate from their initial plans to establish industrial clusters that connect with the domestic economy of the hosting country, at least for the time being. However, this mindset on the side of the developers was not able to discourage cases where backward linkages were possible. In the Eastern Industrial Zone in Ethiopia, for example, the Chinese Huajian Group has been increasingly depending on local suppliers to secure leather needed for shoemaking. (Brautigam and Tang 2013)

### ***Obstacles to Progress in China's Overseas SEZs:***

Notwithstanding the different milieus China's overseas SEZs have to tolerate, almost all of them seem to suffer with the same types of challenges that obstructed the desired progress. Financial constraints posed as a major obstacle particularly in light of the recent global economic crisis in 2008. In Mauritius and Ethiopia, substantial changes in the SEZs plans were introduced to accommodate the developers' inability to secure necessary funds. In Ethiopia's Eastern Industrial Zone, the Chinese provincial



governments of Zhanjiang and the Jiangsu had to step in to support the developers. Another challenge is the failure to deliver proper infrastructure for SEZs, owing either to the lack of experience of SEZs developers, like in Ethiopia or inefficiency of governments to promptly deliver essential infrastructure as was the case for the Lekki Free Zone in Nigeria. Even the acquisition of land was for some SEZs a tiresome process. Other challenges came as a result of disputes with local communities, primarily on terms and compensations of resettlements and the poor Communication and lack of trust between host government and the Chinese developers have proven to impose lots of obstacles, especially when governments are skeptical about the benefits China will be gaining out of the established SEZs. as indicated below (Brautigam and Tang 2013):

## **II. Case Study I: China-Egypt Suez Economic and Trade Cooperation Zone:**

The China-Egypt Suez Economic and Trade Cooperation Zone (SETC Zone) is based within the broader framework of the North-West Gulf of Suez Special Economic Zone (SEZone) which is located in Suez Governorate next to the city of Ain El-Sokhna, and right across the Ain Sokhna port on the southern entrance of the Suez Canal.

Egypt's interest in the modality of China's SEZ came as part of Egyptian efforts, in 1990s, to induce economic reforms and to stimulate structural transformation rendering the economy export-oriented and more attractive for foreign investment. This interest has been translated into a high-level visit in 1993 by a delegation from the Egyptian parliament to Beijing and several SEZs in Shanghai and Tianjin, followed by a visit by China's Vice Premier to Egypt in 1994. In 1997, a Memorandum of Understanding between both parties was signed, pledging China's support to the setting up of a SEZ in Egypt. (Scott 2013) Consequently, in 1998 the Chinese TEDA agreed to join a joint venture with the Arab Contractors, the Suez Canal Authority, the National Bank of Egypt and the National Investment Bank to establish the Egypt-China Corporation for Investment (ECCI), which purchased the designated part of land in the Suez governorate. In the joint venture, TEDA only had 10 percent. Unsatisfied with its share and hence its inability to implement its vision, TEDA decided in 2000 to acquire 1.34

square kilometers from the ECCI and start a zone of its own. (Bräutigam and Xiaoyang 2011)

TEDA designed its new zone to be an industrial park for medium and small enterprises. By 2006, TEDA was able to conclude the development activities of the zone, setting up a production area of 76,000 square meters and a service area of 40,000 square meters. (Scott 2013)

An opportunity for TEDA to maintain and even expand its zone came with the Chinese MOFCOM's initiative to support overseas SEZs. In 2007 along the second round of tenders, TEDA submitted a proposal to expand the zone into an extended area of 6 square kilometers within the SEZone. The proposal was accepted, and subsequently, TEDA formed a joint venture with Egyptian partners to establish TEDA Egypt. (Bräutigam and Xiaoyang 2011) As per the new arrangement, TEDA Egypt assumed usufructuary rights over the extra 6 square kilometers for 45 years. With investments of USD 200 to 250 million, TEDA is expected to finance, design, construct, operate and maintain this new phase of the SETC Zone. (Sameh 2016)

Before China's initiative to contribute to the establishing of a SEZ in Suez, Egypt's expertise was largely confined to the public and private free zones acknowledged by Law No. 8 of 1997 on Investment Guarantees and Incentives. In fact, Suez itself is a public free zone that consists of a large number of sub-zones including industrial zones, special free zones, qualifying industrial zones, investment zones and general free zones. Notwithstanding the existing frameworks and the fact that it occupies one of Suez's 14 sectors dedicated to special free zones, China-Egypt SEZ came under a variant arrangement that was freshly established in 2002. (Scott 2013)

#### **A. Institutional Framework:**

The Law no. 83 of the year 2002 was especially sketched to regulate special economic zones or, to be literal, economic zones of special nature. In line with this law, the SEZone was established in 2003 by the Presidential Decree no. 35 to serve as the only SEZ thus far.

The law welcomes export-oriented investments from industrial, agricultural and service sectors. As part of its package of incentives, the law set corporate tax at 10% and income tax at 5%. Imports of raw materials and capital equipment are exempted from custom taxes. The following table highlights the main provisions of the Law no. 83. (GAFI 2012)

### Box 1

## Law No. 83 of 2002: Economic Zones of Special Nature

### Main Provisions

*The special economic zones and the authorities that manage them are established by a Presidential Decree. The aim of each authority is to encourage investment (in the economic zone under its responsibility) toward the establishment of projects that are able to compete with comparable ones abroad.*

Each special economic zone has a special customs and tax administration system established by its board of directors with the approval of the Minister of Finance.

Incentives and guarantees offered to projects operating in SEZs include the following:

- The projects operating in economic zones may not be subject to nationalization, nor may they be subject to sequestration, freezing of assets or confiscation (except by a judicial judgment). Projects are entitled to decide on the prices of their products and services without governmental interference.
- Projects may terminate the employment contracts of employees in the special economic zones according to terms simpler than those generally prevailing under the Egyptian Labor Law. Projects are also permitted to establish a special system for the social insurance of terminated employees.
- Each project's income tax is 10 per cent of its net income, with the exception of the income derived from the salaries of project employees, which is taxed at a rate of 5 per cent.
- Profits derived from bonds and loans to establishments in the special economic zones are exempt from taxes; and no sales tax, duty or other direct or indirect taxes may be imposed on them.
- The machines, raw materials, spare parts and components necessary for the authorized activities in the SEZs may be imported without permit and are exempt from customs tax, sales tax and all other taxes and duties. The products of those establishments may be exported without permit. They are subject to the customs tax, sales tax and other taxes and duties only on the imported components of those products when they enter the local Egyptian market.

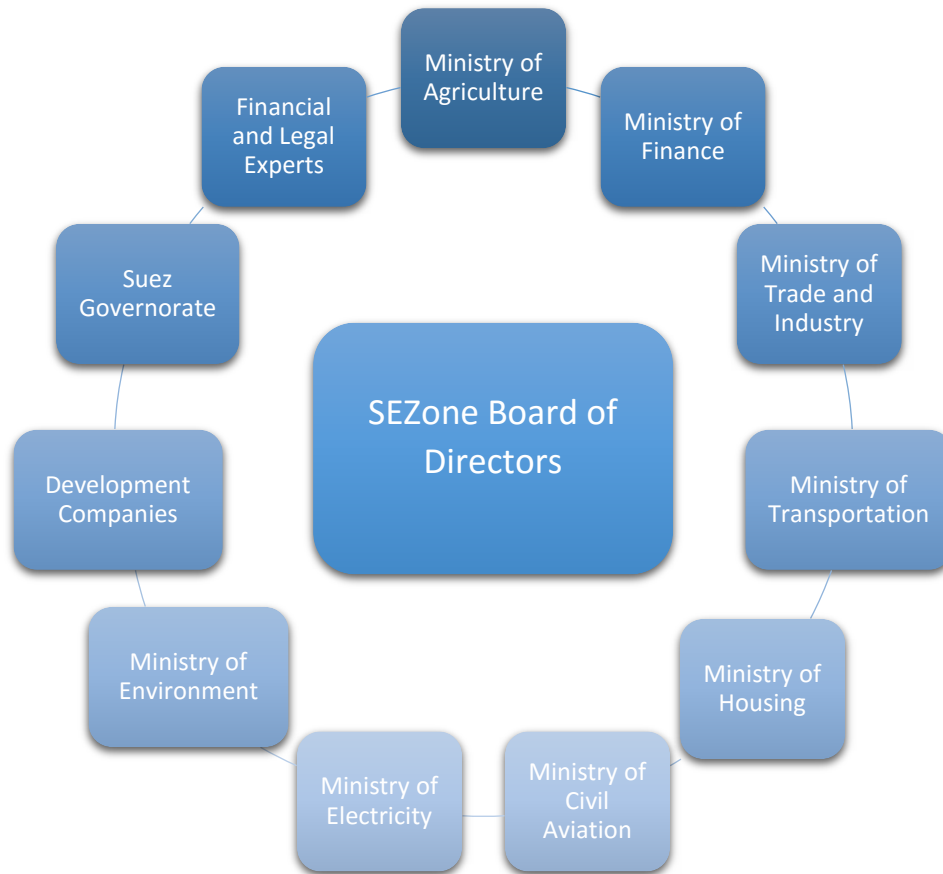
(GAFI 2012)

The preferential policies applied in the SETC Zone are offered through the Law no. 83 which seem to be greatly inspired by their counterparts in China, particularly the Guangdong regulations that stimulated the growth of Shenzhen and its sister SEZs. In fact, some provision on incentives in the Law no. 83 tend to get very close to those prevalent in China's domestic SEZs. The most remarkable resemblances tax cuts and import-duty exemptions. For instance, before the Law no. 27 the year 2015, the corporate tax rate in SETC was set at 10 percent down from the 20 or 30 percent outside the zone, whereas income tax was set at 5 percent down from 10-20 percent. (Scott 2013) Also, the exemptions on imports of equipment, raw material and other manufacturing components tend to take the same direction as in China's SEZs. Almost as in Shenzhen, firms operating in the SETC have freedom to import and export while having only limited access to the Egyptian market.

SETC Zone offers yet another important incentive for investors, one that China's SEZ did not offer. Being under the framework of Law no. 83, the SETC opens up for foreign investors opportunities of special treatment in new markets, taking advantage of the trade agreements in which Egypt is a party, such as the Common Market for Eastern and Southern Africa (COMESA), the Greater Arab Free Trade Agreement (GAFTA) and other free trade agreement with the European Union and the United States of America, like the European Free Trade Association (EFTA) and the Qualified Industrial Zones agreements. (GAFI 2009)

With regards to the organizational structure of the SETC Zone, the Law no. 83 for the year 2002 establishes an authority for any new SEZ with a board of directors that brings together representatives from all relevant ministries to coordinate, facilitate and resolve challenges and obstacles that may arise. As the first applicable SEZ, the board of directors was put into action as in Figure 12.

Figure 12



Having the Board of Directors with all government representatives on top of the SEZone and, hence, the SETC Zone, may be perceived as a way to keep control of the zone. Actually, even if this is true, during this experimental stage, it may be advisable to keep the government present to help the SEZone mainstream the SEZ policies amongst the many stakeholders who are unfamiliar with similar schemes. Involving the government will prove to be beneficial up till the Suez governorate and the SEZone authority are able to assume exclusive regulatory roles. It is worth mentioning, however, that the Board of Directors comprises 3 representatives from the MDC and a representative from Suez governorate.

Additionally, one important aspect of autonomy has been spelled out in the Law 83. According to the Law, companies operating in the zone will never be subject to nationalization, confiscation or freezing of assets.

In 2015, another Presidential Decree was issued to establish the Law no. 27/2015 introducing a number of amendments to Law no. 83/2002, stripping SEZs in Egypt from the 10 percent corporate tax incentive, aligning the tax framework to the national tax regime. Evidently, Law no.27 was an attempt to emphasize and entrench Egypt's interests in the work of SEZs, primarily by linking SEZs' preferential treatment to the extent to which foreign investors are able to positively contribute to the local economy. Law no. 27 has also settled in some governance arrangements that clearly allows for substantial autonomy for SEZs. (El-Halafawy 2016)

#### **B. Development of the SETC Zone:**

The Law no. 83 cited that for every SEZ there shall be an authority that will attend to the regulatory functions, in addition to a "Main Development Company" (MDC) that will serve as the "development arm" within the zone. The SEZone authority is managed through a Board of Directors that brings in representatives from all relevant ministries of Egypt along with representatives from Suez governorate and the development company, in addition to financial and legal experts. As for the development arm, the MDC was established in 2006 as an Egyptian shareholding company with General Authority of the SEZone holding 50.6% of shares. The remaining shares is distributed among the Egyptian-Chinese Corporation for Investment (29.7%), Gulf of Suez Development company (16.4%) and Banque Misr (3.3%). Specifically, the role of the MDC encompasses several capacities, including planning, designing, constructing and operating, managing and maintaining infrastructure and related services and utilities. These functions, however, are either done by the MDC itself "or through specialized industrial developers." (The Main Development Company (MDC) 2015) This exactly where China's overseas SEZ, the SETC Zone, fits. Currently, SEZone occupies an area of 20 square kilometers, 6 square kilometers of which were provided to a Chinese developer as part of China's program of overseas SEZs. This Chinese developer is TEDA Egypt.

Tianjin Economic-Technological Development Area (TEDA) constitutes one of China's SEZ success stories. TEDA is located in the city of Tianjin, northeast of China to the south of Beijing. Tianjin has gained strategic importance with the Grand Canal of China, which links the Yellow river with Yangtze River, passing through its lands, making it in perfect position to serve as a transportation hub along this vital juncture. Tianjin was also able to develop into one of China's major industrial and financial centers, building on its well-established experience as a port for both domestic and international trade. The favorable economic and business conditions of Tianjin were hard to miss. In 1984, only a few years after embarking on with its "Open Door" policies and the SEZs program, the Chinese government decided to establish the TEDA zone in Tianjin. The experience of TEDA as SEZ, or specifically as ETDZ, largely resembles those of other SEZs in China, particularly with regards to its relaxed entry requirement that allowed in the beginning nearly all sectors to come and invest, before tuning its focus, later on, to capital intensive sectors, like electronics. Over the years, TEDA's amazing performance has qualified it to emerge as the most profitable zone of China's 57 state-led ETDZ. (Scott 2013)

In 2008, the China Africa Development Fund (CADF), one of China's instruments to support its overseas SEZs program, has expressed interest in investing in the SETC Zone. This development has altered the management framework of the SETC Zone, with the introduction of the China-Africa TEDA Investment Corporation to the existing shareholders, maximizing the overall share TEDA. Against this backdrop, it worth noting that the SETC Zone became almost wholly managed and supported by the Chinese state, given that the Tianjin Municipal Government has been already providing 5 percent subsidies for companies operating in the zone through their initial capital investments. (Scott 2013)

The notable performance of TEDA in its start-up phase of the SETC Zone, along with the support of the CADF and both the Egyptian and the Chinese government, made it easy for TEDA to win an international tender to develop additional 6 square kilometers with in SEZone's 20 square kilometers.



## Progress to Date

Following the same logic as with China's domestic SEZs and then with its overseas SEZs in developing countries, the progress of Egypt's SETC Zone can be looked at through the same three objectives established for Shenzhen in chapter 3.

### *A. Static Economic Gains:*

#### **1) Volume of Foreign Direct Investment**

The initial or the pilot phase of the SETC Zone, occupying the 1.34 square kilometer of SEZone, started operation in 2006 as TEDA's old industrial park. This has definitely provided SETC Zone with an early head start compared to other participant zones that had to start from scratch after getting past the Chinese MOFCOM's tender process. Hence, it may be argued that if Egypt's SETC Zone is to be set in comparison to the rest of China's overseas SEZs, it will unfairly seem more advanced and far more accomplished, provided that it has built on what has been already existing, i.e. TEDA's Suez Industrial Park almost three years before MOFCOM's second tender in 2007. This is absolutely valid. However, being chiefly interested in analyzing and assessing the SETC Zone experience, rather than matching it with other zones, the advantage of the early start will only allow us more years for a deeper analysis, and will unlikely affect the credibility of evaluation. After all, what has been accomplished before enlisting TEDA zone under MOFCOM's framework of China's overseas SEZs program would have been done afterwards. Only then there would be less content to analyze and assess.

Thus far, SETC Zone's pilot area comprises eight production spaces serving 28 companies in 2014, most of which are small and medium-sized enterprises specialized in a wide range of businesses. (China-Africa TEDA Investment CO LTD 2015) Top investors in the SETC Zone are demonstrated in the following Table.

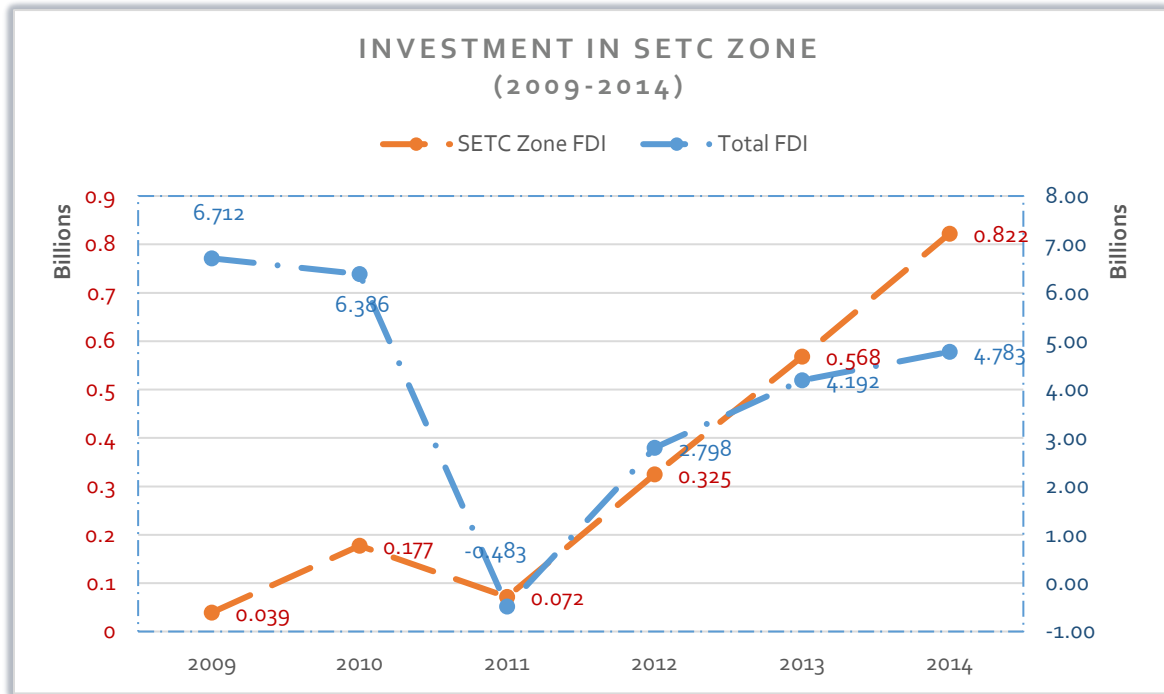
*Table 2*  
*Top Investors in SETC Zone (2014)*

Cluster	Company	Open Year	Ownership	Type of Business	Actual Investment 2014 (USD 1,000)
Textiles and Clothing	China Textiles Machinery Company (CTMC)	2008	Chinese state-owned company	Non-woven medical and agricultural clothing	15,490
Petroleum Equipment	Sino-Egyptian Petroleum HH Rig Manufacturing Company EPHH	2007	Joint Venture <i>China: Sichuan HongHua Petroleum Equipment= 50%</i> <i>Egypt: Petrojet= 27.5%; ENPPI = 12.5%; Tharwa= 10%</i>	Manufacturing and assembly of land and offshore rigs.	18,000
	The International Drilling Materials Manufacturing Company		Joint Venture <i>China: Start Oil and Gas Holding SOG= 40%</i> <i>Japan: Petro Material Corporation PMC = 10%</i> <i>Egypt: Ganoub El Wadi=20%; Petrojet=15%; Enppi=15%</i>	Tubing and casing	12,050
Fiberglass	Jushi Egypt	2012	Chinese	Fiberglass 200,000 tons per year	213,200
Electrical Equipment	XDEGEMAC	2009	Joint Venture <i>China: XD=49%</i> <i>Egypt: EGEMAC=51%</i>	High voltage electrical equipment	68,590
Vehicles and Transportation	Fuyang Light Transport Industrial Company	2006	Chinese	Motorcycles and three-wheel vehicles	11,520

Source: (China-Africa TEDA Investment CO LTD 2015)

The total amount of investments in the SETC zone has grown from 2009 to reach USD 902,910,000 in 2014 (99 percent of which is from Chinese origin) as shown in the figure below.

Figure 13

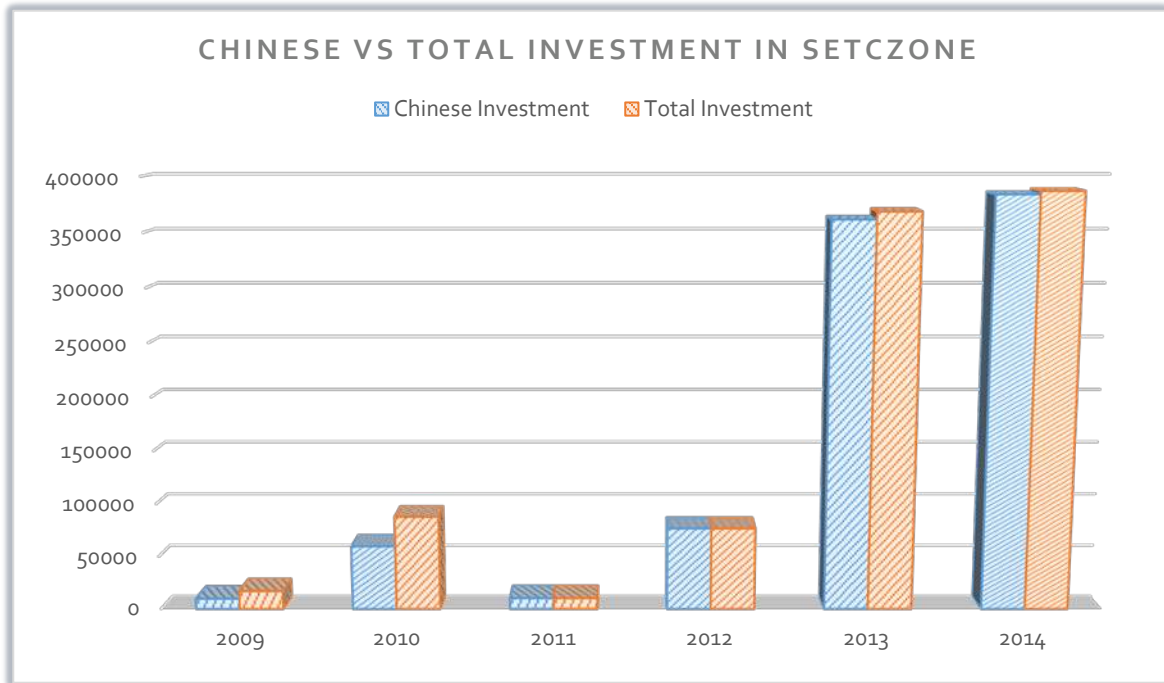


(China-Africa TEDA Investment CO LTD 2015)

As indicated in the figure above the contribution of SETC Zone to the total value of FDI inflows to Egypt has grown steadily, from 0.5 percent in 2009 to a share of 17 percent in 2014. Even in the difficult times of the 2011 Revolution when net FDI inflows went down to USD -483 million, the zone sustained an acceptable level of FDI of USD 72 million. During the period from 2009 to 2014, total investments in SETC Zone accounted for 8 percent.

Out of the 28 operating firms in SETC Zone in 2014, 27 companies belong to Chinese investors accounting for more than 99 percent of total investments in the zone.

Figure 14

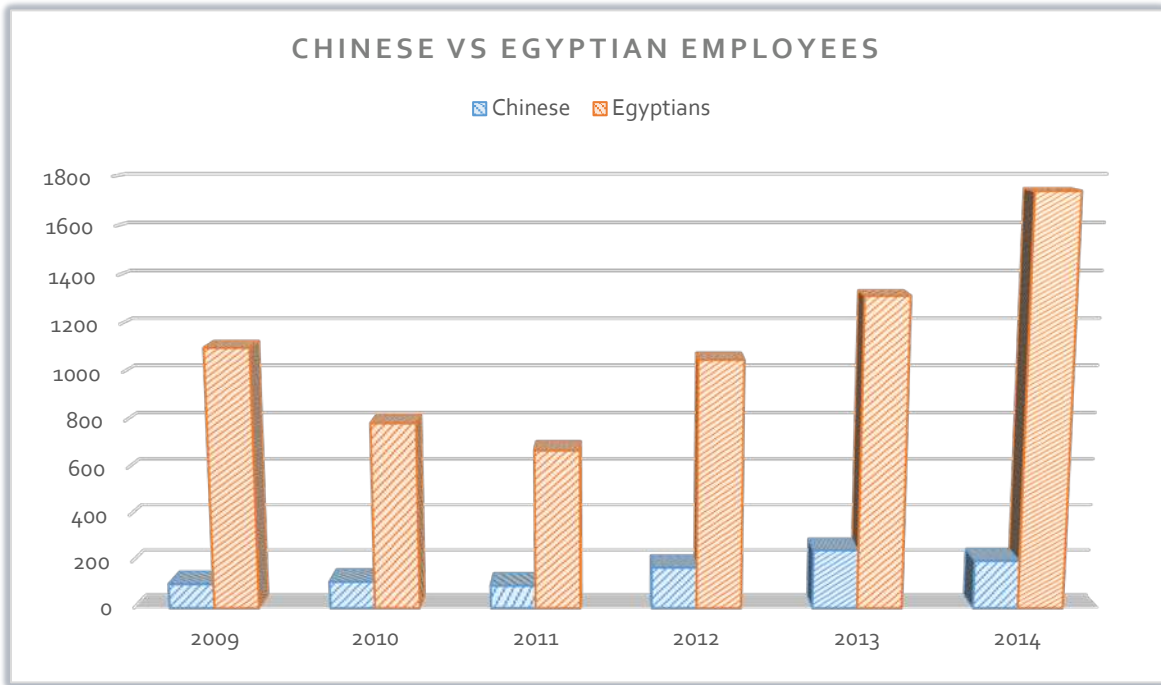


Source: (China-Africa TEDA Investment CO LTD 2015)

## 2) Employment Creation:

Out of the many objectives the SETC Zone aims to accomplish, generating employment opportunities for Egyptians may be the most important to maintain government support for the longest period of time. According to the labor law to which the SETC Zone is accountable, for every nine Egyptian workers one foreign worker is allowed. The following figure shows an increasing trend in the rate of employment in the SETC Zone since 2009 up until 2014 particularly for Egyptian labor. In 2014, the SETC Zone had 1741 Egyptian workers, only contributing by 0.2 percent to the increase in employment at the national level during the period from 2009 to 2014, which have seen 771,700 new job opportunity.

Figure 15

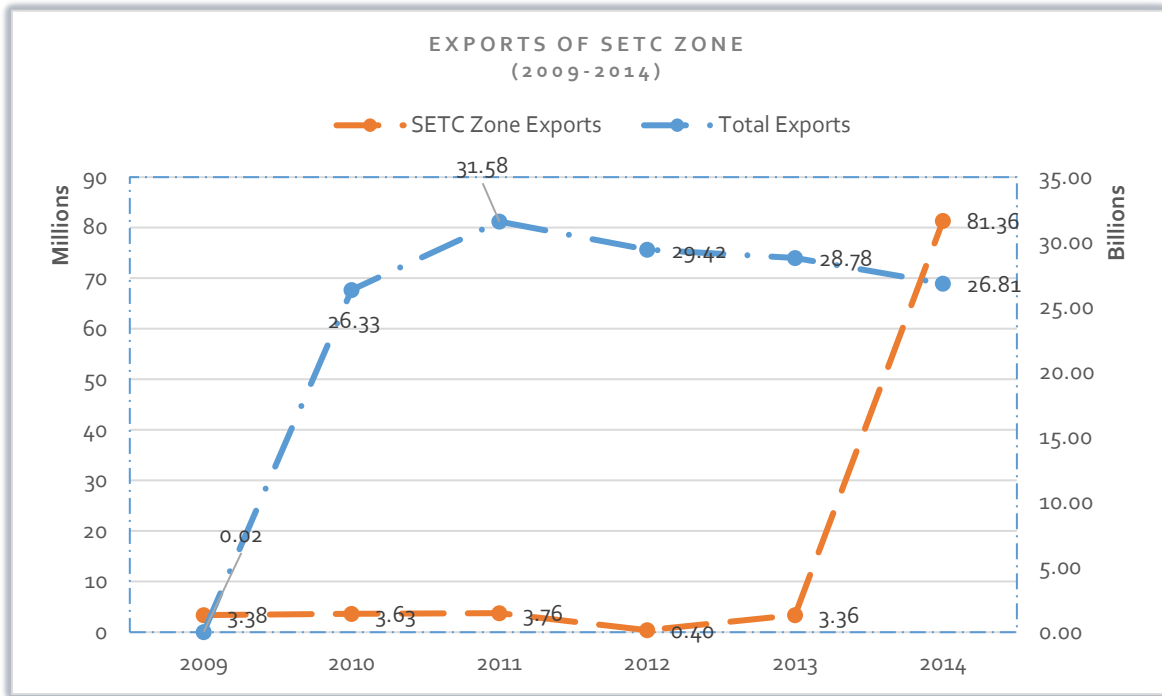


Source: (China-Africa TEDA Investment CO LTD 2015)

### 3) Volume of Exports:

Only in 2014 that the share of SETC Zone exports gained a significant value as a percentage of the total exports of Egypt. With more than USD 81 million of exports in 2014, the share of SETC Zone of national exports jumped from a trivial 0.01 percent to 0.3 percent. The portion is still microscopic. Nevertheless, the figure is at least promising given that 2014 exports in SETC Zone witnessed a growth rate of 2,321 percent compared to 2013 exports, and that the zone is yet in its pilot phase.

Figure 16



Source: (China-Africa TEDA Investment CO LTD 2015),(World Integrated Trade Solution (WITS) 2016)

**B. Dynamic Economic Gains:**

**1) Local Economy Integration (Backward and Forward Linkages/ Global Value Chains):**

Backward and forward linkages are largely realized through the clustering strategy. As been indicated for Shenzhen by Ren Lu, the clustering elements constituted in “knowledge spill, specialized inputs and services from supporting industries, and a pooled skilled labor” are all existing for the SETC Zone.

Especially for its electrical equipment and petroleum products clusters, the SETC mingles well within the broader industrial base of the Suez governorate, at least theoretically. Certainly, in the area of the highest potential of clustering and linking with the local economy is the petroleum equipment companies, given the gifted location of SETC Zone.

TEDA Egypt has also emphasized its plan to attract indigenous small and medium-sized businesses to invest in the SETC zone, particularly in its new 6 square kilometers phase. (Hakim 2016)

However, the work of some of SETC Zone companies may do harm than good to the domestic economy of Egypt. As mentioned, having the Chinese textile CTMC company operating in the zone may expose the local producers to new fashionable methodologies of production. However, up until local businesses are able to cope with the advanced technologies of a company like CTMC, they will have to endure substantial losses resulting from the unrivaled competition with the exports of the Chinese companies.

One concern also lies in the fact that companies with the size and reputation of Jushi and XD are already well-fitted in some established chains of supply, leaving only minimal opportunity of engagement with the local economy of Egypt. (Scott 2013)

Along the same vein, the potential of the SETC Zone to serve as a transfer of technology platform has been hardly recognized. Theoretically, the SETC Zone offers a perfectly conducive environment for the transfer of top-notch technologies and exchange of technical and administrative knowledge, hosting a handful of leading Chinese companies employing the latest in scientific know-how across a wide range of industries. In textiles and clothing, the CTMC can work to transfer its state-of-art techniques in manufacturing unwoven fabrics to revitalize the waning Egyptian textiles industry through mainstreaming new innovative methods of production. Also, in the booming business of fiberglass, the Chinese Jushi offers a great opportunity for transfer of technology to relevant Egyptian producers, especially that fiberglass serves as a key component in the production of solar cells and panels.

Additionally, the joint venture modality followed by a number of companies in the SETC Zone like in XDEGEMAC facilitates the technology-transfer and skills development process even further, with both the Egyptian and Chinese labor working under the same roof.

Another opportunity for knowledge transfer emerges with petroleum equipment-producing companies being located in one of Egypt's most oil-rich areas. In fact, the location of SETC Zone provides a two-way channel of technology transfer for Chinese petroleum companies through the almost direct contact with other experienced foreign and Egyptian firms in the field of oil production and related services.

In skills development, more determination has been observed, especially on the side of the Chinese TEDA which established a vocational training institute.

## **2) Export Diversification:**

Thus far, investors in the SETC Zone have largely ventured in businesses that are far from being unusual to the Egyptian economy or to the Egyptian export portfolio, being focused on the manufacturing of textile products and electrical equipment. Perhaps Jushi's fiberglass business holds the biggest potential in the SETC Zone when it comes to the diversifying of exports. However, actual data can be hardly obtained to verify the export-diversifying effect of Jushi's exports of fiberglass products, especially that it failed to show in the list of exports that witnessed significant growth rates in recent years. (Observatory of Economic Complexity (OEC) 2016)

### **III. Case Study II: Ethiopia's Eastern Industrial Zone (EIZ):**

The Eastern Industrial Zone (EIZ) or Industrial Park is another winning project of MOFCOM's 2007 tender for China's Overseas SEZ. It is the first and largest special economic zone developed in Ethiopia. EIZ is 30 kilometers south of Addis Ababa in the town of Dukem, located on the major highway linking Ethiopia with Djibouti, about 900 kilometers from Djibouti port.

#### **A. Development of EIZ:**

The original development plan of EIZ involved investments of USD 146 million stretching over more than 5 square kilometers of land and managed by the Chinese consortium of two renowned steel companies, Jiangsu Yonggang Group and Jiangsu Qiyuan Group. Both companies had no previous experience in Ethiopia, unlike the developers of the



other Chinese SEZs in Africa. In only five years, EIZ was planned to bring in around 80 projects that would generate 20,000 job opportunities. However, financial constraints that was attributed to the global financial crisis has adversely affected the initial plot of the Ethiopian zone as it made it first steps in the implementation phase. The targeted size had to go down to only 2 square kilometers whereas investments decreased to USD 101 million with Yonggang corporation moving out of the consortium. (Gizaw 2015) (Rohne 2013)

Despite the rough start for the EIZ, the Ethiopian Federal Government maintained its faith in the China-sponsored zone, integrating the EIZ project in its Sustainable Development and Poverty Reduction Program as one of the priority projects that will revitalize the country's industrial development. It is perceived that the EIZ will "act as an excellent carrier of transferring Chinese industry, will be the base of overseas processing trade, and an important bridge for Chinese enterprises entering to market of Africa, Middle East, Europe and America." (Eastern Industry Zone 2009)

However, financing difficulties kept crippling the progress of the EIZ. Financial difficulties for EIZ resulted from the high cost of investment in basic zone infrastructure of water, electricity, transportation facilities and so forth. High cost of infrastructure is largely attributed to the unavailability of construction materials. This has been further accentuated with the limited sources of revenues that the EIZ can rely on to cover the mentioned costs, in spite of the several financial incentives offered by the government of China and Ethiopia. Thus far, leasing charges of land and factory buildings have been the major source of revenues. Against this backdrop, the EIZ may be able to generate profits only after 15 years of operation, as indicated in a World Bank report. (The World Bank 2012)

#### **B. Institutional Framework:**

In the absence of any policy frame, the legal foundations of the EIZ were largely left to existing national laws and regulations on investment, trade, labor and infrastructure, adding much ambiguity to the organizational and operational structure, while depriving

the zone from special entitlements. The development of the EIZ came as a result of a Memorandum of Understanding (MoU) between the Ethiopian government and the Chinese consortium, which seem to have focused only on assigning roles and responsibilities to be taken over by both parties, as illustrated in the below table.

<i>Government of Ethiopia will provide for:</i>	<i>The Chinese Consortium</i>
<ul style="list-style-type: none"> <li>a) <b>30 percent of infrastructure costs,</b></li> <li>b) <b>Land on concessional basis,</b></li> <li>c) <b>20 percent retention of foreign currency earned from exports,</b></li> <li>d) <b>One-stop-shop arrangements,</b></li> <li>e) <b>Assign a representative from the Ministry of Trade and Industry to ensure proper coordination with the Consortium.</b></li> </ul>	<ul style="list-style-type: none"> <li>a) <b>Planning and development,</b></li> <li>b) <b>Management and operation,</b></li> <li>c) <b>Marketing and promotion,</b></li> <li>d) <b>Resource mobilization,</b></li> <li>e) <b>Involuntary resettlement compensations.</b></li> </ul>

(Gizaw 2015)

As indicated in the MoU, the role of management and operation is designated to the Chinese Consortium. Nonetheless, the Ministry of Industry has established a steering committee and technical committee to facilitate the implementation of the EIZ project. An Administration and Management Committee was installed inside the zone to provide business and investment-related services, such as “consultation of investment policy and law, investment and work permit, business license registration, customs declaration, commodities inspection, product storage and transportation, ...” (Eastern Industry Zone 2009)

In line with the most common preferential policies offered for investors in any given SEZ, the government of Ethiopia has set up a package of incentives whereby EIZ investors shall be exempted from 1) import custom duties on capital goods, raw materials and spare parts (up to 15% of the imported capital goods value) only if they

are not available in the local market, 2) export taxes, 3) income taxes within a period from two to seven years, 4) taxes on remittance of capital. (Eastern Industry Zone 2009)

## Progress to date:

### A. Static Economic Gains:

#### 1) Volume of Foreign Direct Investment

In November 2015, China's state television CCTV announced through a televised report that the EIZ hosts 36 manufacturing firms. (CCTV America 2015) However, the detailed descriptions of the operating firms are only available for few firms from research produced earlier. Descriptions are demonstrated in the table below.

Table 3

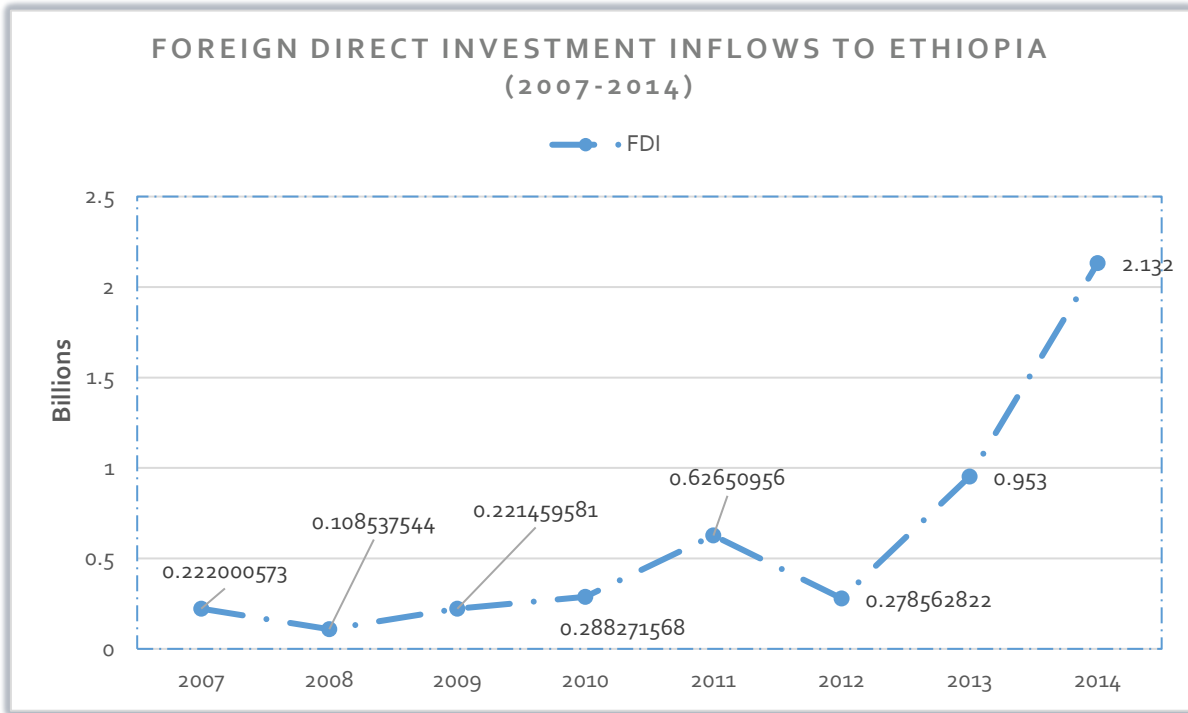
Cluster	Company	Open Year	Type of Business	Actual Investment 2013 (USD)
Textiles and Clothing	Chang Cheng Packaging Co. Ltd.	2010	Woven bags and packaging material	510,000
	Huajian Shoe Co. Ltd.	2011	Leather shoes	-
	Dongfang Spinning Printing and Dyeing	-	Textile and garment	10 million
Construction Products Manufacturing	L&J Engineering Co. Ltd.	2010	Cement products	126,000
	LQY Pipe Manufacturing Co. Ltd.	2010	Steel pipes	9 million
	Eastern Steel Co.	-	Steel products	54 million
	Yulong Technology Building Materials Co. Ltd.	2010	Gypsum boards and related products	420,000

Cluster	Company	Open Year	Type of Business	Actual Investment 2013 (USD)
	Zhong Shun Cement Manufacturing Co. Ltd.	2008	Cement products	11 million
Equipment Manufacturing	Changfa Agricultural Equipment Manufacturing	2011	Tractors, harvesters and other agricultural equipment	-
	Higer Pickup KD	2011	Pickups production	-
Services	The headquarter of East Cement Share Company	2006	Administrative services, personnel management, sales, billing, logistics etc.	60 million
	East Cement Leasing Company	2008	Construction equipment rental service	5.14 million
	Eastern Hotel Co.	2008	Hotel services	500,000

(Rohne 2013)Invalid source specified.

A rough compilation of the FDI amounts brought in by the firms that first moved in EIZ would put the aggregate FDI of the zone at a lot more than USD 150 million, given that the actual investment figures of three of the largest firms among the initial twelve are missing. In addition, the FDI numbers included were last updated in 2013.

Figure 17



(The World Bank Group 2016)

The significant increase in FDI inflows to Ethiopia during the period from 2007 to 2014, as shown in the figure above, can hardly be attributed to FDI inflows to EIZ given that EIZ's USD 150-million of FDI inflows only constitute 3% of the 4.8-billion FDI inflows to Ethiopia on the national level.

## 2) Employment Creation:

The initial target of EIZ was to generate around 20,000 jobs. This target was, in fact, subordinate to the target of opening up more than 80 firms within the zone. In this context and with the modest display of operational companies thus far, employment opportunities generated has gone down. In 2014, Dukem administration reported that the 12 operational firms in EIZ has produced 16,876 jobs, as illustrated in the table below. The number of jobs created may seem satisfactory. This number, however, is humbled when matched with the total number of jobs created in Ethiopia since the launching of EIZ in 2007, which is equal to 9,084,600, making EIZ share less than 0.2%.

Employment Generated			Range of Age		Level of Skill	
<i>Total</i>	<i>Male</i>	<i>Female</i>	<i>20-29</i>	<i>30-39</i>	<i>Skilled</i>	<i>Unskilled</i>
16,876	8,750	8,126	15,189	1,687	10,864	4,262

(Gizaw 2015)

### 3) Volume of Exports:

Exports figures for EIZ are unavailable on the aggregate level. Accessible statistics exist only for some operational firms and within different time frames. For instance, Dongfan Spinning Printing and Dyeing is reported to have exports of 7,556,816.26 Ethiopian Birr during 2015 (equivalent of USD 355,113.546<sup>3</sup>). Also, Huajian International Shoe Company reported USD 18 million of exports during 2014. (CCTV America 2015)

Definitely, these statistics can hardly contribute to a proper estimation of the aggregate volume of exports of the entire zone. And therefore, it may be helpful to have a look at the rate at which the national exports of Ethiopia have increased during the period in which the EIZ has been functional, only to get an overall picture about how EIZ's exports may have contributed to the national volume of exports. According to the Ethiopian Revenues and Customs Authority, Ethiopian exports in the 2007, the year the EIZ was launched, were worth of USD 1,183,268,582. In 2010, when firms got seriously engaged in production, national exports accounted for USD 2,147,314,405, whereas in 2014 exports were equal to USD 2,977,916,072. Against this backdrop, it can be easily inferred that EIZ's share is minute in light of the available data, and given that the commodities that witnessed highest export growth rate during the period from 2007-2014 in Ethiopia were mineral products followed by coffee and other agricultural

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<sup>3</sup> Exchange rate of 31-12-2015.

products, which have nothing to do with the production activities inside EIZ.  
(Observatory of Economic Complexity (OEC) 2016)

***B. Dynamic Economic Gains:***

**1) Local Economy Integration (Backward and Forward Linkages/ Global Value Chains):**

According to a World Bank survey in 2011, 91.5 percent of the surveyed firms in the EIZ indicated high dependency on imported inputs for their production process due the underdeveloped nature of the supply chain mechanisms and unavailability of necessary components, with 61 percent of their inputs secured from foreign sources. Even with all the obstacles that may raise the cost of imported manufacturing inputs, relying on local suppliers have proven in many cases to be far costlier. (The World Bank 2012)

In light of Chenery and Watanabe's approach in analyzing economic linkages which favor "Intermediate Manufacturers" and Final Manufacturers" as having high potential of stimulating economic development, the EIZ is more likely to extend linkages with the Ethiopian economy through firms working under the textile and leather sector. Thus far and given the country's current economic competitive advantage, only this cluster, in addition to light-manufacturing companies, will be able to generate both backward and forward linkages, on top of which is the renowned Huajian shoe company. (Rohne 2013)

Indeed, local leather of Ethiopia manage to find its way in the production of leather goods that serves global markets including Europe. Leather goods production in Ethiopia, however, is not fully reliant on local components. The industry requires a handful of imported inputs.**Invalid source specified.** A good share of leather production as described above takes place inside EIZ, particularly through Huajian Shoe Company. (CCTV America 2015)

Similarly, the ability of EIZ to help attach Ethiopian economy to global value chains is found in the same textile and leather goods producing firms, as they are the only firms employing low-technology and labor-intensive mechanisms of production. (Rohne 2013)

## **2) Export Diversification:**

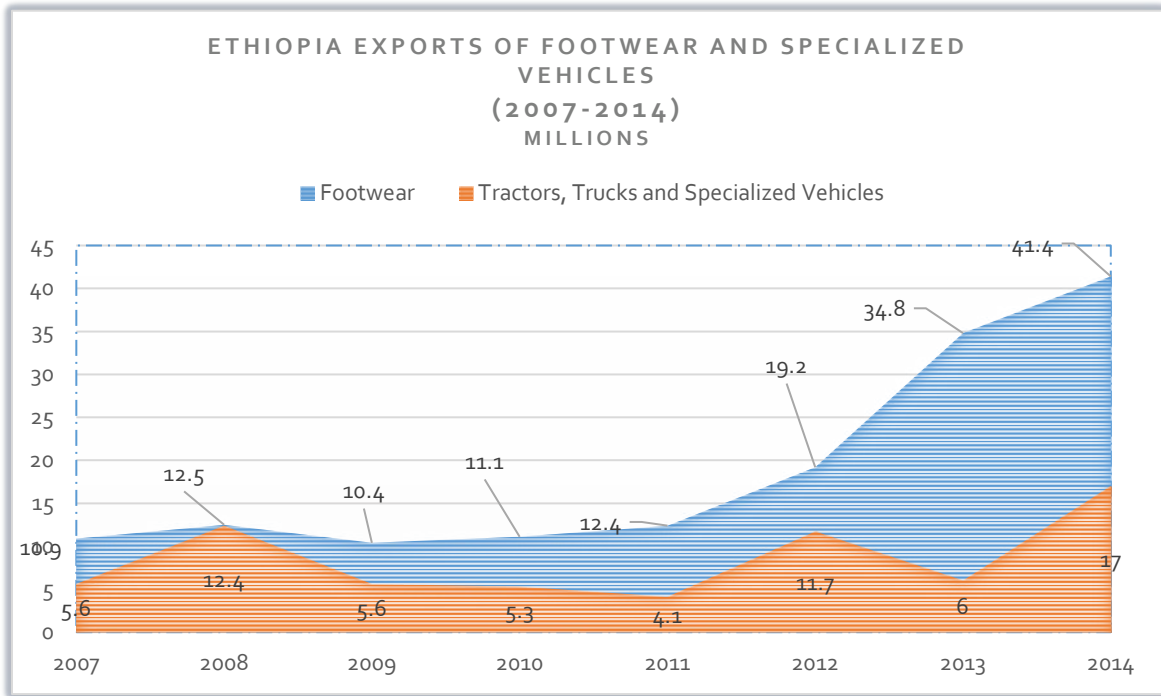
As previously indicated, export figures for EIZ operational firms are mostly unavailable. And even accessible figures seem to be unreliable. In this context, an adequate alternative to assess Ethiopia's EIZ's contribution to economic diversification is to trace the change that exports of EIZ's firms were able to bring about to the overall national export landscape.

As per the most recent information on the companies operating in EIZ, business activities in the zone belong to 4 main sectors: 1) textile and leather products, 2) construction materials manufacturing, 3) specialized vehicles manufacturing, and 4) business services. Only two of the mentioned sectors have an exporting profile; textile and leather products, particularly footwear goods, and specialized vehicles.

As illustrated in the figure below, out of the two exporting clusters in the EIZ, footwear products were especially able to show significant progress, contributing to an increase in national exports of footwear products from USD 10.9 million in 2007 to USD 41.4 million in 2014.



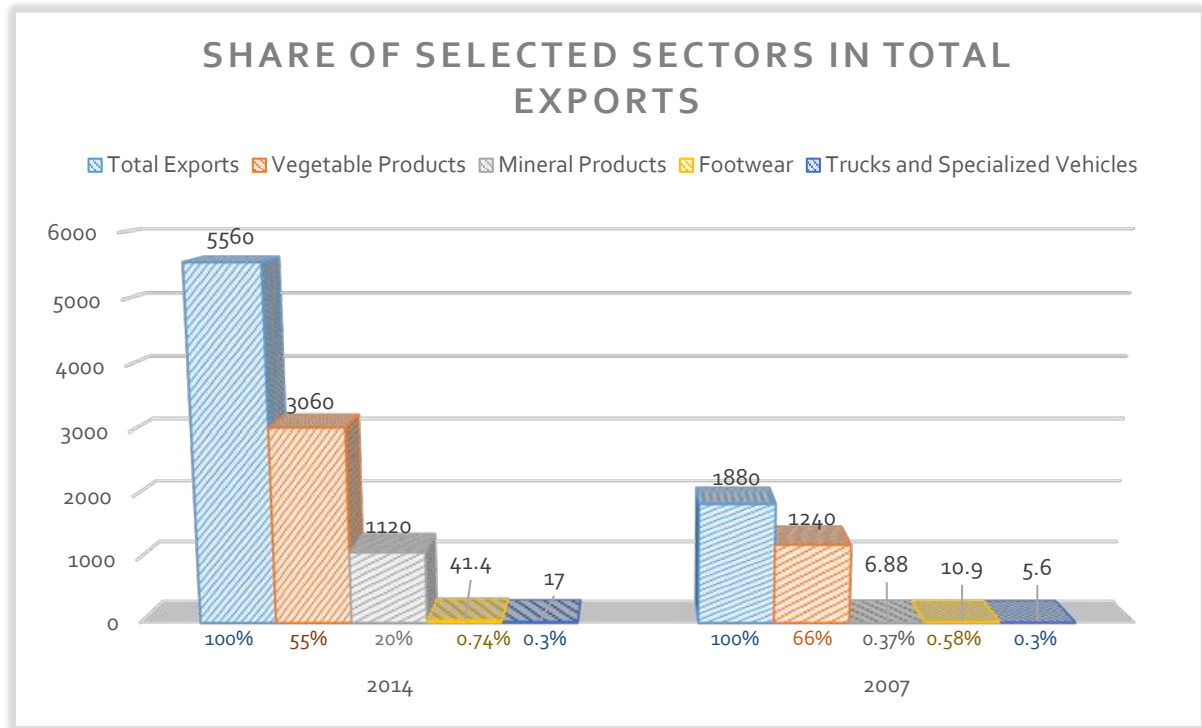
Figure 18



(Observatory of Economic Complexity (OEC) 2016)

However, setting the increase in the footwear products against the increase of the top two exported commodities of Ethiopia, vegetable and mineral products, diminish the diversifying effect of the footwear export increase. In fact, as shown, in the following graph, the share of footwear exports to total exports have only increased from 0.58% in 2007 to 0.74% in 2014, whereas the largest shares were sustained by vegetable and mineral products. It is worth noting that the share of exports from vegetable products have decreased from 66% in 2007 to 55% in 2014, evidently for the benefit of mineral products exports rather than manufactured products. And, therefore, it can be hardly argued that any of EIZ industrial activities have contributed to export diversification in Ethiopia.

Figure 19



(Observatory of Economic Complexity (OEC) 2016)

#### IV. Case Study III: Zambia-China Economic and Trade Cooperation Zone (ZCCZ): Chambishi Multi-Facility Economic Zone (MFEZ):

Launched in 2007, Zambia-China Economic and Trade Cooperation Zone (ZCCZ) is the first of China's overseas SEZs and the first of its kind in Zambia. Basically, ZCCZ refers to two major projects, the original Chambishi Multi-Facility Economic Zone (MEFZ) and the newer Lusaka East MFEZ. Chambishi MFEZ stretches across an area of 41 square kilometers in Chambishi, Kalulushi, part of the Copperbelt Province. Out of the 41-square kilometer area, only 11.58 square kilometers were included for the zone's initial plan that aims at developing a comprehensive special economic zone building on the well-established non-ferrous metal industry in Chambishi. Covering an area of 5.7-

kilometer square, Lusaka East MFEZ, on the other hand, is more focused on commercial services, logistics and real estate industries, taking advantage of its location next to 25 kilometers north-east the capital of Lusaka, which is a well-known communication hub southern sub region of Africa. (Zambia-China Economic & Trade Cooperation Zone Development 2012) (Center for New Structural Economics at Peking University 2016)

#### **A. Development of ZCCZ:**

First in 2007, the government of Zambia granted Chambishi's 41.4 square kilometer on lease to ZCCZ for 99 years, with an aim to bring in USD 800 million worth of investments to upgrade and develop the mine industry in this mineral-rich area. The robust inception of the project resulted from the USD 220-million prompt commitment, the biggest in Zambia's post-independence period, by China Non-Ferrous Metals Mining Corporation (CNMC), the developer and manager of ZCCZ, and Yunnan Copper Industry Group, which later on gave rise to copper smelter that served as an "anchor" investment, producing 15,000 tons of copper per year. (Barton 2016) Chambishi MFEZ was intended to host "heavy and light industries, among them; copper smelting, copper cable and other copper related products, agro processing, manufacture of household appliances, manufacture of bars, wires, electric cables and motor parts." (Ministry of Commerce, Trade and Industry, GRZ 2009)

CNMC's sizable investment in Chambishi MFEZ was, in fact, an expansion of its well-established business in the area. Back in 1998, CNMC won the right to invest in Chambishi Copper Mine to unearth resources of 5 million tons of copper and 120,000 of cobalt. At that point, CNMC's investment in Chambishi accounted for USD 160 million. In July 2003, the Copper Mine started production as planned. (China Nonferrous Metal Mining 2009) Generally, by 2015, CNMC has been able to invest in Zambia USD 2.6 billion, including investments in ZCCZ, offering job opportunities for more than 15,000, 90% of which are Zambians. (Zambia-China Economic & Trade Cooperation Zone Development 2016)

In January 2009, ZCCZ's focus was broadened to involve another sub-MFEZ, Lusaka East MFEZ that, although dubbed an extension to Chambishi MFEZ, had a variant business orientation altering attention to light manufacturing, commercial services, logistic and real estate. (Ministry of Commerce, Trade and Industry, GRZ 2009)

Nonetheless, simultaneously, an extra USD 500 million was further invested by CNMC in 2010 in Chambishi mine in order to raise production of copper ore up to 10,000 tons per day. Infrastructure work in Chambishi MFEZ was concluded in 2011, including a multi-functional facility, covering an area of 5000 square meters, comprises offices, meeting rooms, workshops, in addition to the financial and banking facilities. Completed infrastructure also included 14 kilometers of roads, a 330-kilovolt electricity station, water supply and drainage systems. CNMC has also established the Sino-Zambian Friendship Hospital to serve zone staff and locals. In Lusaka East, the infrastructure of phase I, which covers an area of 1.6 square kilometers, is almost completed including standard workshops, 10 kilometers, 10 kilovolt electricity substation as well as six residential buildings. This, however, does not mean that setting up the infrastructure for ZCCZ was totally smooth. In fact, developers had to take care of the off-site infrastructure after the government of Zambia failed to fulfill its promise in this regard. Power shortage also constitutes a major problem for ZCCZ, to the extent that it had to turn down 10 candidate investors whose potential business required significant quantities of electricity. (Center for New Structural Economics at Peking University 2016)

#### **B. Institutional Framework:**

ZCCZ blends in with the overarching framework of the Triangle of Hope initiative introduced by Japan International Cooperation Agency (JICA) in 2005, to help Zambia make progress in economic development. A major component of the initiative is to provide for a conducive business environment that stimulate and attract domestic and foreign direct investment. MFEZs represented a key tool to realize this goal.

To institutionalize the new tool of MFEZs, the government of Zambia dedicated Section 18 in Act No. 11 of 2006 that establishes Zambia Development Agency (ZDA) to promote investment and trade. Further matters on MFEZs in Zambia were annexed to the Act in Statutory Instrument No. 65 of 2007. As demonstrated in the table below, Act No. 11 in Section 5 clearly designates ZDA to manage, supervise, and regulate MFEZs, among which is ZCCZ two MFEZs, Chambishi MFEZ and Lusaka East MFEZs. In addition to these two, four other MFEZs have been declared by the government of Zambia outside the framework of ZCCZ. These four MFEZs are: 1) Lusaka South, 2) Lumawana, 3) Ndola, and 4) Roma. (Ministry of Commerce, Trade and Industry 2016)

*Box 2*

**Act No. 11 of 2006**

**Section 5 (1) and (2) Articles o, p, q, r**

**5. (1) The functions of the Agency shall be to further the economic development of Zambia by promoting efficiency, investment and competitiveness in business and promoting exports from Zambia.**

**(2) Without limiting subsection (1), the functions of the Agency shall be to —**

(o) develop multi-facility economic zones or facilitate the development of multi-facility economic zones by investors;

(p) administer, control and regulate multi-facility economic zones and ensure compliance with this Act and any other laws relevant to the activities of multi-facility economic zones;

(q) monitor and evaluate the activities, performance and development of enterprises operating in multi-facility economic zones and prescribe and enforce measures, for the business or activity carried out within a multi-facility economic zone so as to promote the safety and efficiency of its operations;

(r) promote and market multi-facility economic zones among investors.

(Government of Zambia 2006)

Naturally, being one form of SEZs incentives serve as an integral feature of MFEZs in Zambia. In that sense, companies operating inside ZCCZ are eligible to the following preferential treatment:

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### *ZCCZ Incentives*

- **Zero percent tax rate on dividends for 5 years from year of first declaration of dividends.**
- **Zero percent tax on profits for 5 years from the first year profits are made. For year 6 to 8 only 50 percent of profits are taxable and in years 9 and 10 only 75 percent of profits are taxable.**
- **Zero percent import duty rate on raw materials, capital goods, machinery including trucks and specialized motor vehicles for five years.**
- **Deferment of VAT on machinery and equipment including trucks and specialized motor vehicles**

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(Zambia-China Economic & Trade Cooperation Zone Development 2012)

In return, potential investors will be considered eligible for entry in the ZCCZ only if they are to invest a minimum of USD 500,000 in one of the priority sectors identified by the ZDA and the ZCCZ. In addition, applicants should be able to guarantee that their projected investments will promote diversification of the Zambian economy, contribute to employment creation, and ensure skills development and transfer of technology, among other economic benefits. (Adjaka, Ammentorp and Nilsson 2013)

## **Progress to date:**

### **A. *Static Economic Gains:***

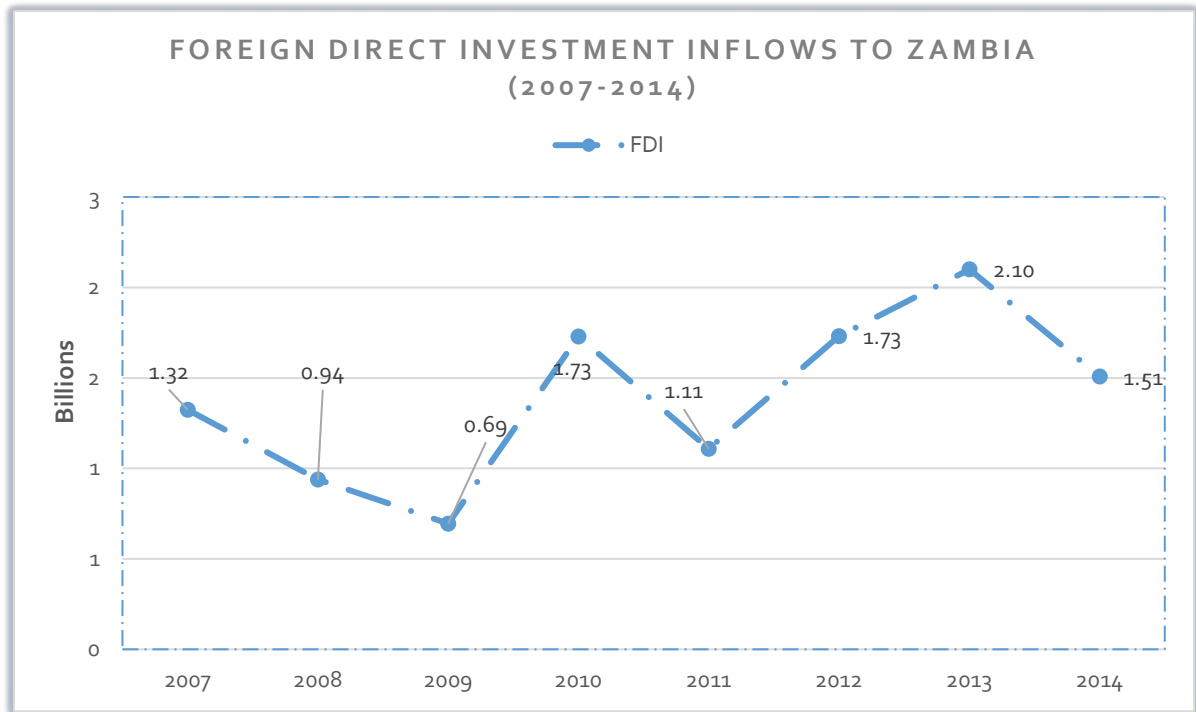
#### **1) Volume of Foreign Direct Investment**

By the end of the year 2014, total value of investment in Chambishi MFEZ was reported at USD 1.2 billion accumulated by 28 companies working in mining and smelting of copper, manufacturing of mining equipment, mining services, as well as manufacturing of mining-related vehicles, chemicals as well as providing for necessary logistics and banking services. (UNDP 2015) Recent figures in 2016 have set the amount of accumulated investments in Chambishi MFEZ at USD 1.3 billion generated by 48 companies. (Center for New Structural Economics at Peking University 2016)

In newer Lusaka East MFEZ, investments have reached USD 19 million, by the end of 2014, out of ten companies specialized in light manufacturing, logistics and real estate, particularly in agriculture, agro-processing, construction materials, car repair services and housing. The zone also hosts an international exhibition center. One of the major investors in the zone is Zambia Jihai Agriculture Company, which is famous for its mushroom production. (UNDP 2015)

Combining both zones together will establish total investments within ZCCZ in 2014 at USD 1.22 billion, most of which are from Chinese origin, accounting for more than 10% of the total FDI inflows to Zambia during the period from 2007 to 2014 as shown in the figure below.

Figure 20



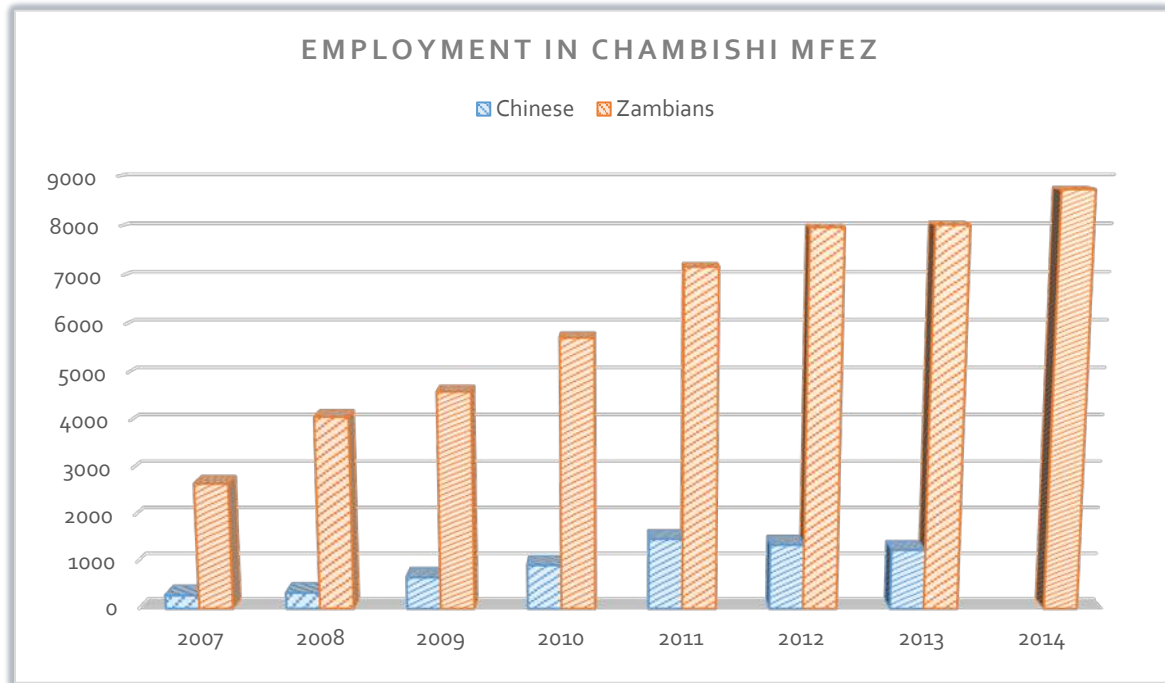
(The World Bank Group 2016)

## 2) Employment Creation:

ZCCZ has managed to generate 8,860 permanent job opportunities, predominantly held by Zambians. As shown in the figure below, the share of the Chinese in total employment has markedly decreased over the years.



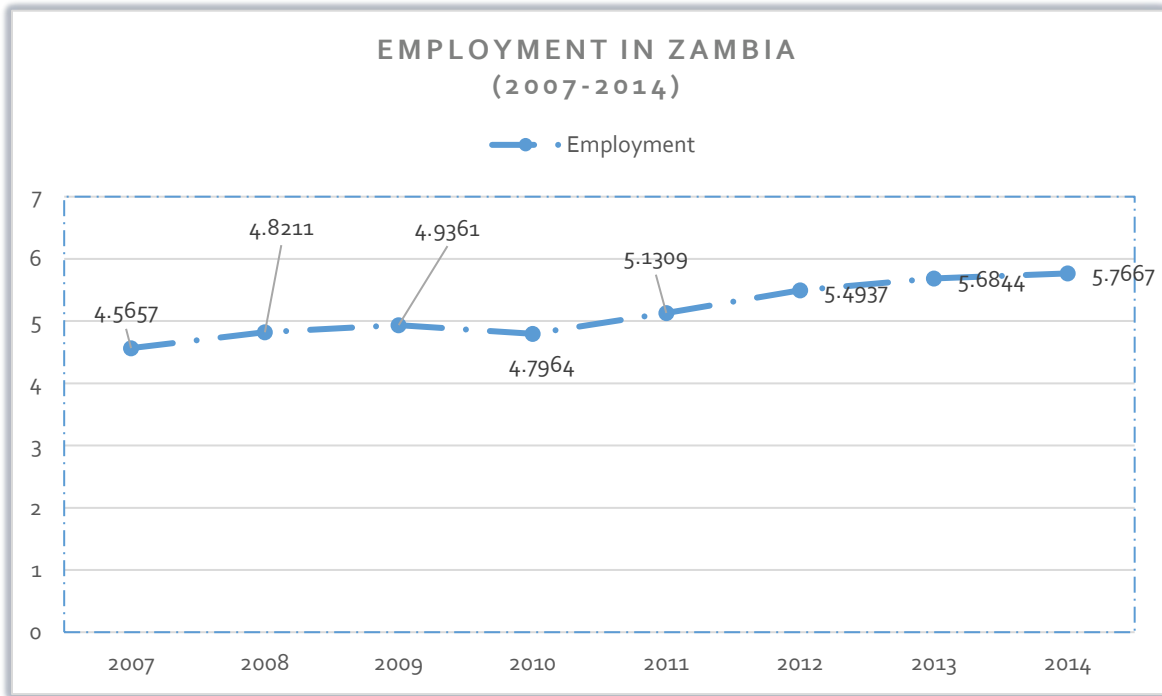
Figure 21



(UNDP 2015)

According to International Labor Organization's estimates and projections, total employment from 4.57 million in 2007 to 5.77 million in 2014 as shown in the figure below, with an increase of 1.2 million. This brings ZCCZ's contribution to employment increase to a very insignificant 0.7% during the ZCCZ's lifetime. This trivial contribution to employment can be only justified by the fact that mining industry, on which ZCCZ is largely founded, is a capital-intensive type of business, rather than labor intensive.

Figure 22



(International Labour Organization (ILO) 2016)

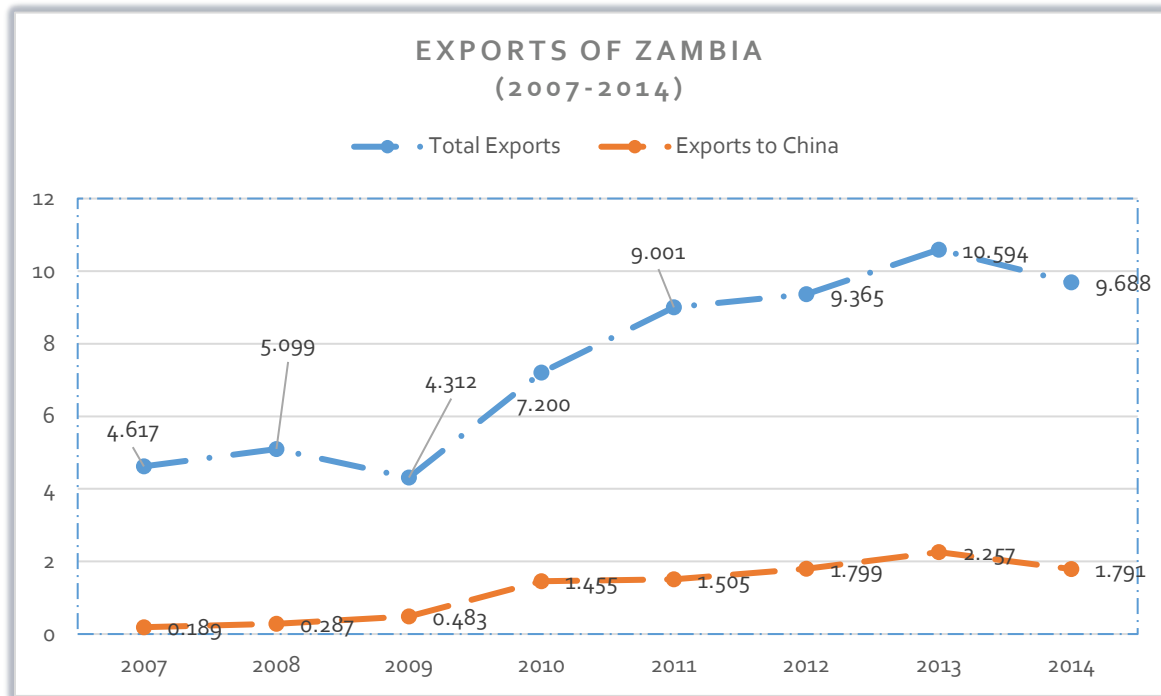
### 3) Volume of Exports:

By establishing industries that add value to raw copper, Chambishi MFEZ is helping increase the worth of Zambian exports. Zambia is known to be a major exporter of copper in its raw form. Transforming raw copper into manufactured products will certainly add more value (i.e. price) to it, and, hence, will contribute to the increase of the aggregate value of exports.

The inaccessibility of export figures for ZCCZ makes it difficult to identify the actual contribution of the zone to the growth of total exports in Zambia since 2007. Even rough estimates can hardly be established especially that total Zambian exports to China, which is expected to be one of the major export destinations of ZCCZ products, has increased with small rates during 2007-2014 period compared to the high rates by which total exports have been growing during the same period as shown in the figure below. ZCCZ's share in exports growth may be rather recognizable when looking into the

main products that lead the increase in total exports. This will be discussed, next, in the Economic Diversification section.

Figure 23



(World Integrated Trade Solution (WITS) 2016)

## B. Dynamic Economic Gains:

### 1) **Local Economy Integration (Backward and Forward Linkages/ Global Value Chains):**

Views on ZCCZ's contribution to the Zambian economy, in terms of backward and forward linkages, vary significantly, even among government officials. Those who de-emphasize the role of the Chambishi MFEZ are largely skeptical about the Chinese intentions in enhancing the Zambian backward and forward capacities in the mining sector. This view emphasizes the exploitative nature of the Chinese investments. Mr. Guy Scott, the Vice President of Zambia has this pessimistic view, maintaining that Chambishi MFEZ is "an opportunity for companies to avoid paying tax for smelting copper." For Mr. Scott, the only linkage created by Chambishi MFEZ is the backward

linkage of employment. In the same vein, the Former President of the Chamber of Mines, Mr. Nathan Chishimba, sees no room for economic linkages, primarily because the Chinese firms, unlike Western investors, are more inclined to use their imported inputs rather than stimulating input of local suppliers. Mr. Chishimba, however, admits that the lack of linkages is also attributed to the weak supply chains in the mining sector of Zambia. (Granath and Larsson 2012) It is indeed difficult for local suppliers to compete with the much-modernized Chinese and multinational companies that have dominated the supply chain of the mining sector in Zambia for long. Maybe the only opportunity for Zambian local firms that supply goods and services, which require modest skills and technology, such as the manufacturing of construction material as well as other intermediate services, like electrical and mechanical engineering, transportation, etc. (The World Bank 2014)

On the contrary, a director at ZDA was appreciative of the Chinese contribution through the Chambishi MFEZ, which adds value to raw copper to produce intermediate and finalized commodities that reach out with global value chains. (Granath and Larsson 2012)

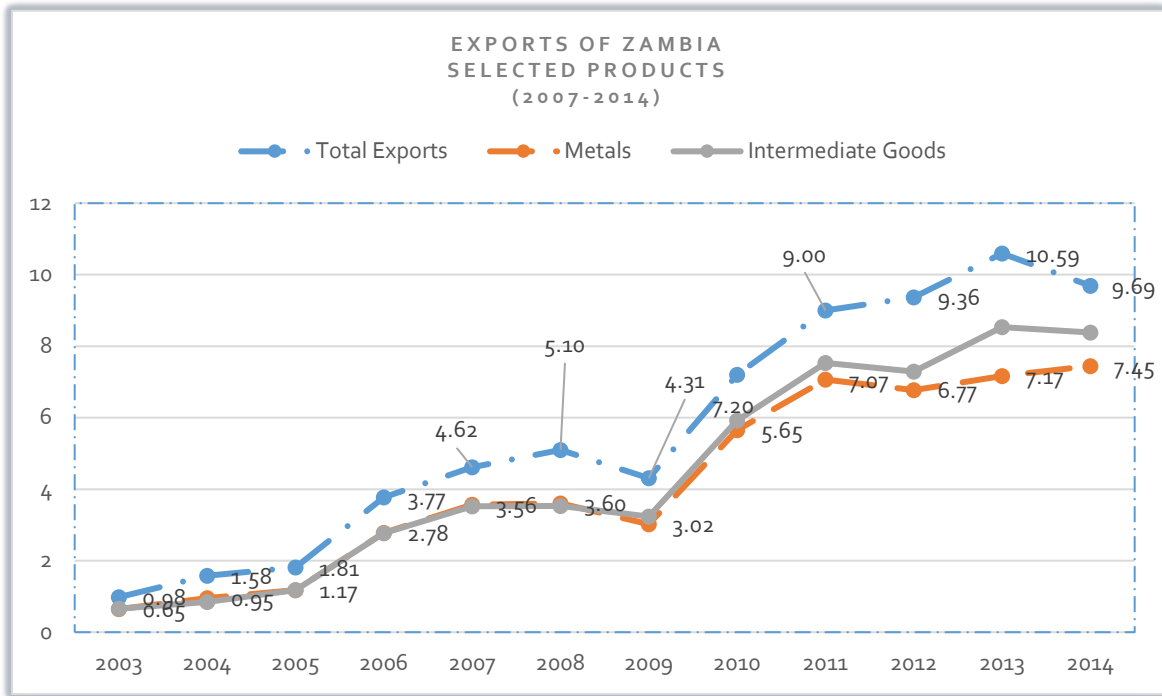
While the potential of ZCCZ to establish backward and forward linkages is high, especially for Chambishi MFEZ, little evidence has been presented to demonstrate actual progress on that front, except that forward linkages that are triggered through the value-addition done by the mine-processing industries, such as the copper smelter. It is worth noting, however, that the government of Zambia has introduced certain arrangements that would provide small and medium-sized companies with access to work with foreign investors within ZCCZs. (Granath and Larsson 2012) Furthermore, in 2013, the Chamber of Mines together with the Zambian Association of Manufacturers launched the Zambian Mining Local Content Initiative to help local supplier better engage through linkages with “parent” companies. (The World Bank 2014)

## **2) Export Diversification:**

Taking into account the fact that Lusaka East MFEZ has not yet fully developed, only Chambishi MFEZ shall be considered for assessment. As indicated in the figure below, there seem to be a clear correlation between exports of metals (mostly copper) and total exports of Zambia, with exports of metal almost accounting for every rise and downturn in the value of total exports. The upward trend in the value of metal exports (and consequently total exports), can be partly attributed to the rise of copper prices. But certainly upgrading metal products, particularly copper, from its raw to more developed intermediate forms has significantly contributed to the evident increase in the market price of Zambian exports from metals.

Furthermore, there is an umbilical relationship between exports from metal products and intermediate goods. However, this relationship goes back to early 2000s, years before the launching of Chambishi MFEZ, implying that processing raw metals existed before the rise of the zone. But certainly, the rate at which the value of intermediate goods from metal products have increased drastically in the years following the establishment of the zone, and its famous copper smelter.

Figure 24



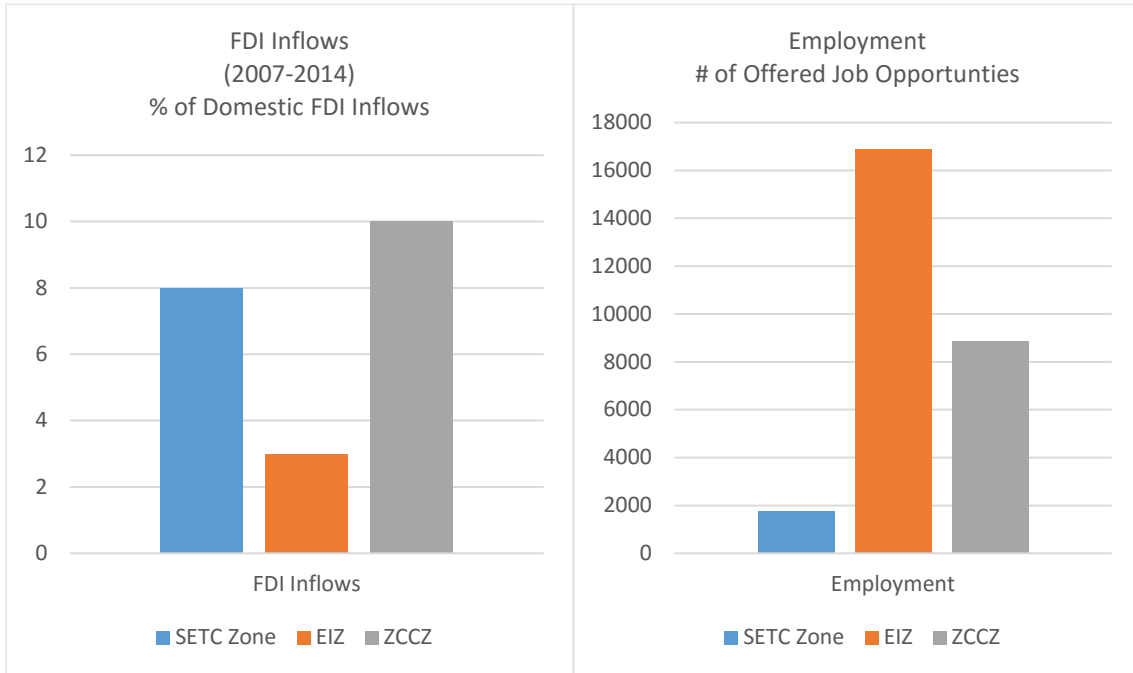
(World Integrated Trade Solution (WITS) 2016)

### Concluding Remarks

Thus far, and after almost a decade since the launch of the Chinese program of overseas SEZs, benefits are significantly below what has been projected for each of the participating SEZs. The development phase has proven to be quite overwhelming for China's overseas SEZs in Africa, lasting for more than three years in most cases. During this period, most of the infant SEZs had to endure and tolerate financial constraints, poor delivery of infrastructure by host countries, among other challenges. The bumpy start of China's SEZs should not, however, be taken as a failure. In fact, several zones proved to have enough persistence to prevail over the obstacles they encountered, and eventually managed to show significant progress. The progress is slow but, definitely, in the upward direction, as demonstrated through the three case studies featured in the chapter. Progress, however, has been, largely, limited to static economic benefits,

particularly, in terms of FDI inflows and employment creation, as illustrated in the figures below.

Figure 25



Dynamic economic benefits were almost non-existent for the three zones. Available information about forward and backward linkages between SEZs and the local economy is inadequate and confined to wishful thinking. The potential may be there but no actual progress has been reported thus. Similarly, the three zones have shown almost untraceable contribution to export diversification. Perhaps Zambia's Chambishi MFEZ was the only one of three that managed to display progress through the rising share of processed copper in Zambia exports.

## Conclusion

In many ways, China’s strategy to develop overseas SEZs within selected countries of the global South can be considered an outgrowth of its domestic SEZs program that was launched in late 1970s. From that perspective, matching the performance of China’s overseas SEZs to that of its domestic SEZs at least during their early stages can prove to be quite helpful, to serve as a yardstick of evaluation upon which overseas zones can take required correctional measures.

*Table 4*

	Shenzhen 1979-1984	China’s overseas SEZs 2009-2014*		
		SETC Zone	EIZ	ZCCZ
FDI as % of National FDI	16	8	3	10
Contribution to Employment % of Employment Growth	0.3	0.2	0.2	0.7
Contribution to Exports Growth % of Total Export	0.3	6.7	-	-

\* Operational Period

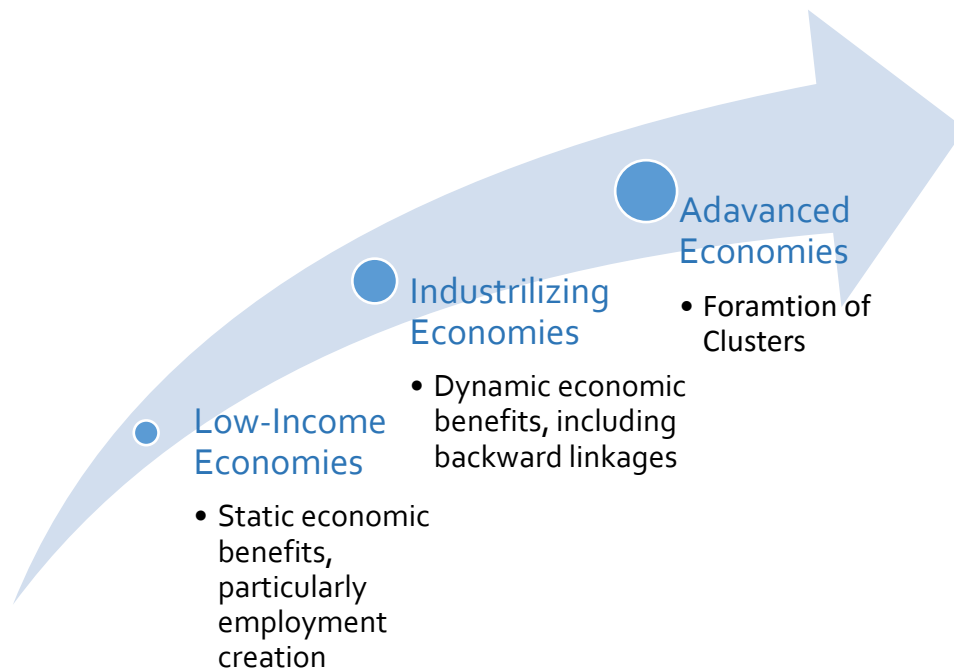
- Unavailable Data

Against the measurable static outcomes, the performance of China’s overseas SEZs in Africa, represented through the three case studies, was comparable to the performance of Shenzhen during its early years. In fact, in some aspects, as illustrated in the table above, Africa’s SEZs has outperformed Shenzhen. To the contrary, China’s overseas



SEZs, unlike Shenzhen, were evidently unable to extend their impact beyond the direct, short-term benefits, with almost no traces of linkages with the local economy that would allow for more long-term dynamic effects. Even if few linkages have come up, they have probably been accidental. Alternatively, in Shenzhen, integration with the local economy was a deliberate policy by the Chinese government, where local producers were encouraged to join the SEZ framework to scale up and be able to fit in with the supply chain of foreign high-technology producers. As for industrial/export diversification, China's overseas SEZs in Africa will have to reach a level of maturity to start reaping significant benefits of economic diversification. After all, Shenzhen had to pass through three distinct stages, before being able to increase the share of high-technology industries in China's national exports.

While matching the performance of China's overseas SEZs to that of Shenzhen, and each of them to one another, has its merits, it is of high importance to bring attention to the fact that the impact of SEZs is very much subject to the level of development of the host country. What SEZs can realize for primitive, agrarian economies in Africa is different from what can be accomplished in middle-income, industrializing economies or in highly industrialized advanced economies. Peter Warr and Jayant Menon identify the benefits that are more likely to develop within the different stages of development as follows (Warr and Menon 2015):



Hence, judging the success of a SEZ should take into account the nature of the economy of the host country and its level of development.

Nevertheless, and no matter how less developed a country is, it should clearly be stated that SEZs are able to bring about significant outcomes to the host country only if they were fitted within a long-term, nationwide strategy of economic liberalization. I would assume that the benefits realized through SEZs, either static or dynamic, are, primarily, dependent on the host government's determination and commitment. In fact, the miraculous performance of Shenzhen would not have been sustainable without the backing of her fellow SEZs and, certainly, the government's adequate management of its Open Door policy. After all, a single, detached, unsupported SEZ can hardly stimulate economic growth, even if this SEZ was Shenzhen.

It is worth noting that the dissertation had to tolerate the inaccessibility of comprehensive data, specifically on progress indicators of the Ethiopia's Eastern Industrial Zone and Zambia's Chambishi and Lusaka East Multi-facility Zones, resorting, in few instances, to estimates. Even though the inadequacy of data has not obstructed the evaluation process of the two zones, getting hold of more exhaustive and time-bound figures would have helped better situate the performance of the zones in relation to one another, and in comparison with Shenzhen's performance. The lack of thorough statistics on China's overseas SEZs can be attributed to the novelty of the program. Hence, further research is needed to keep track of this evolving experience.

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