CENTRE FOR CHINESE STUDIES
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# Special Economic Zones in South Africa: Lessons for further development

**In 2018 South Africa reaffirmed its support for Special Economic Zones (SEZs) by approving the preferential tax treatment status of SEZs. South Africa has run a number of industrial development programmes such as Industrial Development Zones (IDZ) since 2000, however, the ongoing efforts have not yet been fully actualised. With new supportive fiscal incentives for businesses in SEZs, the South African government aims to revive industrialisation and to promote inclusive development.**

**Dube in KwaZulu-Natal and Coega in the Eastern Cape have a relatively long history of operation and investors are already active in these zones. Despite excitement around new government support, challenges experienced in the zones have been identified through interviews with stakeholders. By examining the most common challenges, further policy and systematic development will become possible. In this way lessons can be learned and used in the newly launched zones such as the Atlantis SEZ in the Western Cape and other zones in South Africa and beyond.**

## Transition from the IDZ to the SEZ

Already in 2000, South Africa designated and formalised the IDZ programme. East London and Coega IDZs in the Eastern Cape, the OR Tambo IDZ in Gauteng, the Saldanha Bay IDZ in the Western Cape, and Richards Bay and Dube TradePort IDZs in KwaZulu-Natal became operational during 2001 and 2014. Performance of the six designated IDZs, however, has been lower than expected. For example, Coega IDZ created only 2287 jobs, significantly lower than official expectations that stood at 20,000 by 2014.

Problems in South Africa's business environment - negative economic growth, the volatile exchange rate, small or shrinking domestic markets, lack of a supply chains in both backward and forward linkages, labour-related issues, and an unstable social environment - have been identified. The lack of support from the government, such as the absence of fiscal incentives, poor stakeholder co-ordination and cross-cultural issues have all negatively affected the success of the IDZ programme. From the perspective of investors already operating in the zone, many of the preferential conditions and benefits have not been fully realised either.

In order to improve the institutional support for and incentives to invest in the IDZs, the Department of Trade and Industry (DTI) set up the SEZ programme. The SEZ Act was enacted to allow the establishment of SEZs in 2014 and came into effect in 2016. All IDZs in operation before 9 February 2016 were incorporated into the new SEZ programme for greater effectiveness. Since 2016, SEZ incentives, such as tax benefits including Income tax concessions, Employment Tax Incentive (ETI) concessions and Value Added Tax (VAT) concessions, have taken effect. To date, nine originally identified areas were designated, of which six received final approval from the Minister of Finance.

The tax incentives for qualifying companies include: VAT and customs relief, if located within a Customs-Controlled Area

**Table 1. Incentives for investors in SEZs in South Africa**

| | |
|---|---|
| **Reduced corporate tax rates** | 15% instead of 28% |
| **VAT & customs relief** | VAT & customs relief (if located within a Customs-Controlled Area) |
| **Other benefits**<br><br>Source: DTI | Employment Incentive for employers employing low-salaried employees, Building Allowance, 12I Tax Allowance, One-Stop Shop Facility<br>SEZ Fund |

(CCA); employment tax incentives; building allowances and reduced corporate income tax rates. In addition, a SEZ fund and Technical Advisory Services are also available (see Table 1). However, successful SEZs are dependent on "sound legal and institutional frameworks, efficient public services (such as a one-stop shop that offers a comprehensive range of services within the zone) and good infrastructure, ongoing skills training, continuous technological and industrial learning, innovation, upgrading and strategic and strong connectivity and linkages with the community". Fiscal incentives such as tax holidays can play a necessary but partial role; experts show that "smart incentives" such as incentives for R&D could be more effective and beneficial to both the host country and the investor in the long run

## Best practices in South Africa: Dube and Coega

### *Dube TradePort SEZ*

Strategically positioned on the East Coast of South Africa, around 30 km North of the city of Durban, the Dube TradePort (DTP) links the ports of Durban and Richards Bay. The DTP comprises of Dube TradeZone, Dube AgriZone, Dube Cargo Terminal, Dube City and Dube iConnect. It is operated by Dube TradePort Corporation (DTPC). The Dube TradeZone includes logistics, warehousing, manufacturing and distribution, freight forwarding, consolidators, integrators, high-tech industries, textiles, pharmaceuticals and electronics. The first phase (Dube TradeZone 1) has been completed and is fully operational. Currently Samsung and Yangtze Optics Africa (YOA) Cable and other multinationals, as well as South African companies, are operating in Dube TradeZone 1. An Indian car maker, Mahindra, plans to open a plant too. Based on this success, the development of Dube TradeZone 2 is underway.

As of September 2018, DTP SEZ has secured ZAR 3.2 billion from private sector investment, with plans to attract over ZAR 10 billion of private sector investment over the next five years. The zone has resulted in the creation of an overall 12,997 temporary job opportunities and 3,088 permanent jobs. With regard to the development of infrastructure, Small, Medium and Micro-sized Enterprises (SMMEs) are involved in construction. Local SMMEs in the region have revived, and the construction sector will be active along with the expansion.

### *Coega SEZ*

Coega has been operational for the past 19 years and it is the best performing zone in South Africa. As of January 2017, Coega IDZ reported that currently there are 45 operating investors with a total investment of ZAR 11.685 billion, and created 102,794 direct jobs. Coega SEZ is focused on automotive, agro-processing, chemicals, general manufacturing, business process outsourcing and energy. A Chinese manufacturing company, First Automobile Works (FAW) is in operation; the Beijing Automobile International Corporation (BAIC) Group, a Chinese state-owned enterprise, also plans to establish a car manufacturing plant in the zone.

Both DTZ and Coega SEZ have geographic competitive advantages. These zones have strong regional and international logistics channels through rail connections, good access to major road networks, ports, and international airports. These are conducive to access domestic and international markets. Furthermore, these zones are relatively well integrated into urban areas which enables close collaboration with key stakeholders in cities and regions nearby.

Additionally, the infrastructures of these zones have gradually developed. Coupled with well-developed infrastructure offering cargo terminals, warehousing, manufacturing, offices, retail, and hotels makes DTP itself which is an attractive investment destination for local and international investors. Coega also provides readily adaptable facilities for investors so that they can avoid long-term construction and connectivity problems. Within the zones, there are specialised service points where investors can easily operate. Roads, electricity, sewage treatment, water supply and telecommunications are also available.

Therefore, investors can immediately operate businesses in the zones. However, general infrastructure outside the zones in the region should be developed simultaneously. In the case of Port

**Table 2. Dube and Coega SEZs**

| | Dube | Coega |
|---|---|---|
| **Size (Hectare)** | 3,500 | 11,500 |
| **Operation starts** | 2012 | 1999 |
| **Investment *Value (ZAR)** | 3.2 billion | 11.685 billion |
| **Major investors** | Yangtze Optics Africa (YOA) Cable, Samsung | Beijing Automobile International Corporation (BAIC), First Automobile Works (FAW) |
| **Job Creation** | 3,088 permanent job and 12,997 indirect job | 102,794 direct job and indirect jobs |
| **Notes** | The only SEZ in Africa with an international airport, dedicated cargo terminal, warehousing, offices, retail, hotel and agriculture | Biggest SEZ in size in South Africa |

Elizabeth, where Coega is located, facilities such as the port have depreciated and require upgrading.

## Challenges for further development

A number of aspects, both conducive and prohibitive to the success of the zones, have been identified.

### *Institutional support and incentives*

The newly enhanced regulatory framework for SEZs will offer attractive incentives to investors. For instance, in Coega, Zone 1 and Zone 2 are designed as Customs Control Zones (CCAs) to comply with SARS requirements. The status of CCA will benefit investors such as FAW in the automotive industry. The establishment of CCAs in IDZs has been discussed since 2000 but has not yet been implemented. Tax incentives have been available since July 2018, in which investors are permitted to claim the 15 per cent SEZ corporate tax rate.

The One Stop Shop (OSS) is another example that reflects the lack of coordination and institutional support in the context of South Africa. OSS facilities are still in the development phase in South Africa, with the first one introduced only in 2017. While OSS, a single window mechanism, offer opportunities, it has suffered coordination issues within various agencies. Insufficient coordination between various government departments negatively affects efficiency. Coega's One Stop Investor Service Centre is an example: It was first proposed by the Industrial Development Corporation (IDC) but has not yet been fully implemented. One of the most important yet unavailable services of One Stop Service Centres is the Visa application support and assistance service for employees of the overseas investors.

### *Lack of clusters*

In general, companies within SEZs tend to cluster to benefit from shared inputs and productivity spillovers. A number of companies currently operating in DTP are from different industries and have different value chains. It seems unlikely that such disparities will generate agglomeration economies. In other words, if a certain sector specialises, the companies, services, and industries within the zone and the region can benefit from cost reductions and gain in efficiency. The government should identify industrial capacity and realign target areas considering each zone's business environment.

### *Labour disputes*

One of the reasons that foreign investors are put off investing in South Africa is due to labour issues. Coega has experienced repeated strikes. Agni Steel South Africa experienced a strike due to wage negotiations in December 2017. This month-long strike negatively affected the company's operations. In the case of Dube, Transnet workers joined a national strike, causing congestion and backlogs of trucks entering the Durban's port in July 2018.

Foreign investors find such events overwhelming and difficult to resolve on their own. When a strike takes place, guidance, labour expertise and negotiation services should be provided. In addition, language barriers persist between investing companies' managers, local employees and Coega Development Corporation

**BOX 1. Atlantis Zone**

Currently cabinet has approved the decision by the DTI to designate the Atlantis industrial area, Western Cape, as a SEZ. Efforts have been made to promote the renewable energy and green tech sectors in Atlantis since 2010. In 2011, the city of Cape Town established a manufacturing hub for green technologies in Atlantis, which has attracted numerous investors. Five of these investors are already operational. Based on this, the Western Cape government later submitted an application for Atlantis to be declared a GreenTech SEZ. South Africa has promoted the renewable energy sector, with the city of Cape Town aiming for renewable energy make up 20 per cent of total energy used in the city by 2020. Major investors including China's Powerway Renewable Energy and Suntech Power holdings are already active in South Africa in the renewable sector. Other companies will most likely follow in their footsteps. A total of ZAR 1.8 billion is expected to be invested in the Atlantis SEZ by 2022. The zone is expected to create 1,200 direct jobs.

(CDC) management. Interviews with the management of FAW and BAIC point out that the language barrier has had a negative influence on daily operations and communication with local labourers and the CDC management. In certain instances, investors have had to give up negotiating due to language barriers and subsequent misunderstandings. Cultural adaptability and cross-culture management issues were also often reported by investing companies.

Due to a lack of knowledge of the South African local business environment, history and the cultures of each group, foreign investors often encounter problems like the sub-groupings in working teams related to different ethnic groups, confusion in culture-related decisions, and inappropriate communication skills.

## Concluding remarks

Combined with financial resources, the development of human resources should be prioritised. In South Africa, industrialisation projects mostly aim to create labour-intensive work. Skills and technology transfer should be prioritised simultaneously with job creation. For instance, Dube and Coega annually sent staff to visit and train in China's most successfully developed SEZs in Tianjin, Shanghai and Shenzhen. Empowering local communities can result in procurement opportunities in the future.

South Africa's diversified economy and sophisticated system has attracted foreign investors. It is important to improve the regulatory regime so that the safety of investment "against expropriation, restrictions or discrimination" should be guaranteed. As of 2018, South Africa's business environment has deteriorated, which has led to a number of institutional challenges. According to Doing Business, South Africa (82) is ranked much behind other countries in Africa such as Mauritius (25), Rwanda (41), Kenya (80) and Botswana (81).

South Africa has committed itself to attracting foreign investment. In addition to business delegations' visits to South Africa, various bilateral and multilateral mechanisms have been introduced. The fundamental goal of the establishment of SEZs is to improve the general investment conditions, as well as enhance regulatory measures and incentives in South Africa. The success of the programme should function as a catalyst, aligning itself with broader industrialisation plans at the national level and within the context of an increasingly amicable business environment.

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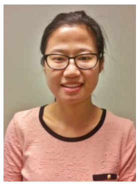

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