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China's Investment in African Special Economic Zones: Prospects, Challenges, and Opportunities

Deborah Brautigam, Thomas Farole, and Tang Xiaoyang[1]

China's recent moves to establish special economic zones (SEZs) in several African countries can make a significant contribution to industrialization in Africa. But the success of these projects is by no means guaranteed. Meeting the objectives of both China and African countries will require an active partnership and a framework for collaboration that includes engagement from host governments, processes for phasing-in local control, communication and enforcement of standards, and support for integration with local economies.

Growing Manufacturing Trade and Investment between Africa and China

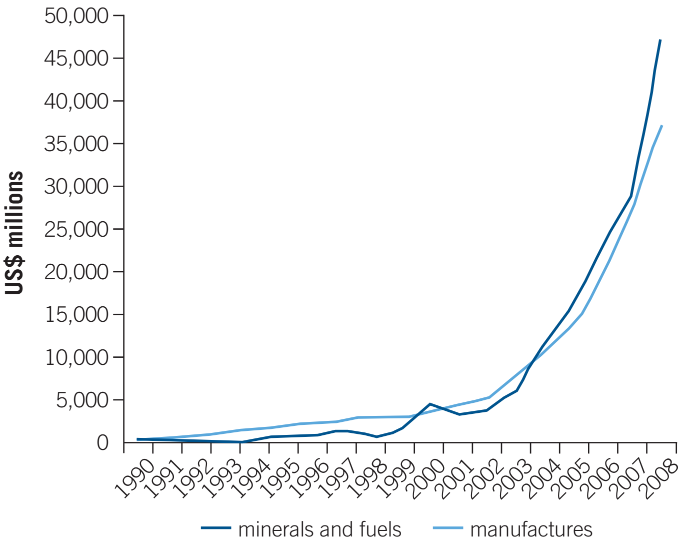
Trade between China and Sub-Saharan Africa has grown over 100-fold since 1990. Although there has been much focus on China's interest in securing supplies of natural resources from Africa, trade in the manufacturing sector is also growing dramatically (see figure 1).

This trade is also opening the door to increasing direct investment in manufacturing on the continent, as Chinese exporters look to supply African markets and take advantage of low-cost labor. A potentially important channel for this investment is through industrial parks or SEZs. In 2006, the Chinese government announced that it would support the establishment of as many as 50 overseas "economic and trade cooperation zones." Of the 19 zones approved so far, 5 are in Sub-Saharan Africa: in Ethiopia, Mauritius, Nigeria (two), and Zambia.[2] (See table 1 for a description of the zones.)

Weak Industrial Competitiveness in Africa and Relatively Poor Experience with Zones to Date

Accelerating industrialization is critical for African countries to reduce poverty and meet their Millennium Development Goals. Most of the continent remains stuck in established trading patterns that rely on exports of raw materials. African industries have largely struggled to reach scale and to compete in global markets: firms in Africa are almost 20 percent less competitive than firms in other regions (World Economic Forum, World Bank, and African Development

Figure 1. Total Trade between Africa and China, 1990–2008



Source: COMTRADE via WITS.
Note: Data illustrate the total value of exports from China to Sub-Saharan African countries plus the total value of imports into China from Sub-Saharan African countries.

Bank 2009). Factors that contribute to weak industrial competitiveness include lack of policy stability, poor infrastructure, and high indirect costs related to a poor business environment.

SEZs offer a combination of world-class infrastructure, expedited customs and administrative procedures, and (usually) fiscal incentives that overcome barriers to investment in the wider economy. SEZs have been used successfully in many developing countries (particularly in East Asia) to facilitate competitiveness, foster export-oriented production, and promote wider economic reforms. Although some African countries—notably, Mauritius, and to a lesser extent, Kenya and Madagascar—have had success with zones, many of the problems that plague the wider investment environment in Africa have also hindered development of most SEZ projects on the continent (FIAS 2008). These problems include infrastructure shortfalls, administrative weaknesses, ineffective management, policy uncertainty, and poor strategic and operational planning.

Table 1. Overview of Trade and Economic Cooperation Zones in Africa Approved by the Chinese Ministry of Commerce

Country and zone	Total investment	Size	Start of planning	Status	Chinese developers	Industry focus
Zambia, Chambishi	US$410	11.58 km^2 (7.98 km^2); start-up 2.00 km^2	2003	In operation and construction	China Nonferrous Metal Mining Group	Copper and copper mining–related industries
Zambia, Lusaka	Subzone	5 km^2	Not available	Construction	China Nonferrous Metals Corporation	Garment, food, appliances, tobacco, and electronics
Nigeria, Lekki	US$254 million for 2–3 years; Y 2.52 billion (US$369 million total)	30.0 km^2; first phase 10.0 km^2; start-up 3.5 km^2	2003	Construction	China Civil Engineering Construction, Jiangning Development Corp., Nanjing Beyond, China Railway	Transportation equipment, textile and light industries, home appliances, and telecommunications
Nigeria, Ogun	Y 1.5 billion (US$220 million) for start-up; US$500 million for whole first phase	100.0 km; first phase 20.0 km^2; start-up 2.5 km^2	Early 2004	Construction	Guangdong Xinguang, South China Developing Group	Construction materials and ceramics, ironware, furniture, wood processing, medicine, computers, and lighting
Mauritius, originally Tianli but renamed Jinfei	Y 1.5 billion (US$220 million) for first phase; US$720	2.11 km^2; start-up 0.75 km^2	2006–07	Construction	Shanxi-Tianli Group, Shanxi Coking Coal Group, Taiyuan Iron and Steel Company	Manufacturing (textile, garment, machinery, high-tech), trade, and living and service (tourism, finance)
Ethiopia, Oriental (eastern)	Y 690 million (US$101 million	2 km^2; start-up 1 km^2, with 10 km^2-reservation area	2006–07	Construction	Yonggang (quit), Qiyuan Group, Jianglian International Trade, Yangyang Asset Management, Zhangjiagang Free Trade Zone (not a shareholder)	Electric machinery, steel and metallurgy, and construction materials

Why Might China Be Different?

There are several reasons to believe that Chinese SEZ projects in Africa might succeed where others have failed. First, China is the world's foremost success story in using SEZs as a tool for attracting foreign direct investment and promoting export-oriented industrialization. Starting in 1979, with the establishment of 4 SEZs in the southeastern coastal region of China,[3] the country has established more than a 100 zones of various kinds. These zones have become one of the principal means by which the Chinese government at local, provincial, and national levels provides preferential policies to foster the development of technology and industry. China learned from the experiences of the Republic of Korea and Singapore, and experimented with different zone models across the provinces. Over time, China's national and provincial governments and its private zone developers have built up substantial expertise in planning, developing, and operating SEZs.

Second, the effort to establish the zones in Africa is part of an important Chinese government initiative, the aim of which is as much political as it is economic. In 2006, the Chinese government announced that it would establish as many as 50 overseas "economic and trade cooperation zones." These serve several economic objectives as part of China's "going out" (*zou chuqu*) strategy: increasing demand for Chinese-made machinery, reducing trade frictions and formal barriers imposed on Chinese exports to Europe or North America, assisting China's domestic restructuring by sending mature industries offshore, and creating economies of scale for overseas investment. But in the process of transferring one element of China's own industrial development success to other developing countries, the zones play an important political role as part of China's extension of "soft power" on the continent. As such, there is great political pressure to ensure that these projects succeed. This pressure can be seen, for example, in President Hu Jintao's intervening to move forward the project in Mauritius and his presiding at the opening ceremony of the Chambishi Zone in Zambia.

Third, the high-profile nature of this initiative has translated into a package of generous financial and nonfinancial support for the zone projects from the Chinese government. The Ministry of Commerce established a competitive tender process for zone projects, under which winning bids are eligible to receive incentives that include grants, long-term loans of as much as Y 2 billion (US$294 million) and subsidies to cover up to 30 percent of some preparation costs, rebates on interest for Chinese bank loans, and diplomatic support in working with host governments.[4] The China-Africa Development Fund (a fund of US$5 billion set up by the Chinese State Council) has taken equity shares in three of the zones. Some Chinese provinces offer additional incentives. China is also offering increasingly preferential trade terms for African countries: at the 2007 Forum for China-Africa Cooperation, China extended duty-free access to 440 products for African least-developed countries; at the 2009 forum, it announced an extension of this access to 95 percent of products.[5] The combination of incentives and trade preferences may open up significant opportunities for Chinese firms to use African zones as an export platform back into the Chinese market.

Finally, despite the substantial government incentives, the Chinese zones in Africa are profit-driven initiatives, led by private sector consortia (although many of the lead firms are national or provincial state-owned enterprises). The Chinese government designed the program to ensure that developers have a profit motive because they view this as critical to ensure sustainability. This is in line with international experience, which suggests that private sector SEZs tend to operate more effectively than government-led zones; in Africa, however, such private sector projects have been rare (FIAS 2008). All the zones are being developed by Chinese consortia, sometimes in joint ventures with local interests, as in Nigeria and Zambia. (In Ethiopia and Mauritius, there is no local partner.) Experienced operators of China's SEZs—Tianjin Economic-Technological Development Area, Nanjing Jiangning Development Zone, and Zhangjiagang Free Trade Zone—are involved in several African zones.

Projects Are Still in Their Infancy, But Many Challenges Have Arisen

China's initiative to develop SEZs in Africa is still in its very early days. Of the five zones, only the Chambishi Zone in Zambia[6] is operating. The SEZs in Nigeria (Lekki Free Zone and Ogun Guangdong Free Trade Zone) and Mauritius are in relatively advanced stages of construction, and the Oriental Zone in Ethiopia remains in the planning stages. To date, some high-level knowledge sharing and training of local managers has taken place; but local employment, supply chain links, and technology transfer remain limited. As of November 2009, the most advanced zone—Chambishi in Zambia—has attracted 11 companies and US$760 million in investment, with 5 additional companies expected in 2010. It employs about 4,000 workers (80 percent of whom are local). However, most of the 11 companies invested thus far are subsidiaries of the developer China Nonferrous Metal Mining Group (CNMC) and already were present in 2006. Moreover, of the 4,000 workers employed, only 600 are in the zone itself, with the majority in the mines or at other CNMC subsidiaries.[7]

Although it is premature to draw any conclusions, it is clear that some positive progress is evident but its pace is slow, and the challenges that have arisen suggest that success is by no means guaranteed. Indeed, these projects not only face many of the typical difficulties that afflict large infrastructure projects, particularly in Africa; they also must confront additional issues of cross-cultural communication, governance, political factors, and power relationships. (See box 1 for an example of the challenges faced in one project.)

Based on their experience at home, Chinese developers expect host governments to actively support zone development; instead, they are finding in some projects (such as in Ethiopia) that governments allocate land to developers and do little else. Developers have also been frustrated by the lack of progress or poor quality of infrastructure provided by some local governments outside the zones. In addition, many of the projects have faced difficulties related to land acquisition and compensation. Although these issues have normally been the responsibility of host governments, they have contributed to project delays and friction with the local communities (Lekki is an example). Finally, although the political situations in the countries hosting zones are generally stable, abrupt policy changes and conspicuous gaps between de jure policy and de facto implementation have been problematic. Chinese companies have found that promises of services like "one-stop shops" can fail to materialize (for example, in Ethiopia). Even when express registration of investments has been set up, obtaining licenses and work permits has caused delays (in Nigeria and Zambia, for example).

African governments and civil societies also have raised concerns on a number of levels. One of the biggest issues relates to lack of transparency and poor communication. Although governments are privy to the contracts signed for these zones (in most cases), the contracts have not been published. This lack of transparency is not problematic only for civil society, but also contributes to misunderstandings among the partners themselves (see box 1). Some of these problems relate to language. For example, at one of the zones, African officials report that relationships improved when their Chinese partners brought in a couple of high-level officials who were fluent in English. Some African officials also worry that Chinese companies may use the zones to bring in Chinese goods for re-export with African labels into areas where African exports receive special incentives, and to enter local markets without paying duties (as has been an issue in Sierra Leone). The use of Chinese rather than local materials and labor also has been a concern in certain projects (such as the one in Mauritius). Chinese nationals also tend to take most of the management and technical

Box 1. The Lekki Free Zone in Nigeria

Nigeria's Lekki Free Zone (being developed by a consortium of Chinese investors[1] in partnership with the state government of Lagos) is perhaps illustrative of some of the challenges facing both sets of partners in executing joint-venture SEZs in Africa. The project, an ambitious effort to create a "model city" on 30 square kilometers just east of Lagos, has been in the planning stage since 2003. Although it has made significant progress, and initial investors are expected to be in place in the first half of 2010, the development path of the project has faced many obstacles along the way. Among those obstacles are these:

- *Financing constraints and partnership disputes*—Construction was delayed for a period because of financial constraints on the part of the Chinese consortium; this apparently was linked to a dispute over partnership terms within the Chinese consortium.
- *Miscommunication over partnership terms*—The Nigerian partner expected the Chinese consortium to deliver its share of investment in capital, whereas the Chinese partners expected to deliver it in-kind through infrastructure development. In addition, there have been concerns from the Chinese partners about infrastructure responsibilities of the Nigerian partner (for example, access to the gas for the power plant). Chinese partners also have raised concerns over the Nigerian partner's potential to ensure that the enabling policies critical to the success of the zone actually will be implemented by the Nigerian federal authorities.
- *Local community disputes*—Local communities around the project protested over resettlement terms, the construction of utility lines through their communities, and the employment of Chinese workers for construction. This protest caused project delays and resulted in transferring 5 percent of the Nigerian partner's shares to the local community. In addition, negotiations resulted in increasing employment opportunities for workers from local communities.

Note

1. The Chinese investors are CCEC-Beyond Consortium, led by the China Civil Engineering Construction Corporation.

positions, at least in the initial project stages. For unskilled jobs, concerns about wages and working conditions have been raised—although most of these concerns are theoretical at this early stage of development. Finally, there are concerns that the zones will become Chinese enclaves, unconnected with the rest of the domestic economy. Although all the zones are open to any foreign and (with the exception of the Mauritius zone) domestic investors, and there is no explicit preferential treatment given to Chinese investors, the reality to date in most of the zones is that investor interest has come primarily from Chinese companies. Thus, in the absence of proactive efforts to promote integration, Chinese enclave zones are a real risk.

A Collaboration Framework to Support Win-Win Partnerships

The practice of partnering to develop of SEZs is part of a long-term process of strategic engagement between Africa and China. It offers a significant opportunity to contribute to job creation, industrialization, and poverty reduction in the region. To fulfil this potential, however, the projects must be successful from business, social, and environmental perspectives. Such success will require a partnership framework that includes the following elements:

1. *High-level commitment and active engagement from host governments*—As noted earlier, China itself learned many aspects of SEZ management through building zones with overseas partners. These lessons were widely applied throughout China's SEZs, and they have become common practice today. African governments have been less strategic at managing the projects as learning experiences. Few of the governments participate actively in the management of the projects or have set up specific programs aimed at developing SEZ expertise over the long term. Assigning specific individuals (preferably Mandarin-speaking people) to work with Chinese development teams can help, as can high-level participation on boards.
2. *Phasing-in local control*—China's experience with Singapore followed a phased model where Singapore interests held control for the first stage of the project, and then Chinese interests took over. In the African zones, Chinese companies have been granted concessions of 50–99 years, and there appears to be no clear plan for phasing-in local control when local management has mastered the zone skills. It is sometimes a difficult balance, because too much local involvement can hinder the operational processes in the early stages before skills, trust, and understanding have developed between the partners. Having a systematic plan to gradually increase local management and shareholding can help ensure ongoing learning, while maintaining efficiency.
3. *Ensuring the provision of good-quality off-site infrastructure*–Worldwide, getting zones off the ground has proved difficult partly because of infrastructure inadequacies (power, roads, water, and sanitation). Public-private partnerships or other models, such as independent power producers, are options that can accelerate this development, bringing employment and other benefits online earlier. Involving the local private sector, in addition to Chinese investors, will be critical.
4. *Communicating and enforcing standards*—Local job creation, environmental sustainability, and labor standards all depend on African governments enforcing existing standards and regulations. It may help to have these standards and regulations translated into Mandarin, as Mozambique has done for its labor regulations.
5. *Implementing programs to promote links with domestic markets*—African countries will not profit from the dynamic benefits of SEZs without ensuring closer links between the (mostly Chinese) foreign investors in the zones and the domestic private sector. Supplier development programs and initiatives to help local companies set up operations inside the zones can play an important role in creating these links. The recently announced funding from the Chinese government to support African small and medium enterprises and plans to help these enterprises invest in the zones could provide a foundation for improving links.
6. *Transparency and community relations*—When contracts and agreements for these important zones are not made public, suspicion can fester. For the zones to be sustainable, they need to have buy-in from local communities. These communities need to understand the nature of the agreements. In the Lekki project, for example, transferring 5 percent of the shares of the Nigerian consortium to the local community was one way to address some of the local concerns.

Notes

1. This Economic Premise is based on a more detailed note on the subject produced by the authors in December 2009. It is available from the International Trade Department of the World Bank. To request a copy, please send an email to tfarole@worldbank.org.

2. China's definition of "Africa" includes the entire continent, not just the sub-Saharan portion. Under China's definition, two additional zone projects are ongoing in Africa—in Algeria and Egypt. In addition, there are other

Chinese industrial zones that are private initiatives without any "official" support from the government (for example, in Botswana, Sierra Leone, and South Africa).

3. A fifth zone was added later on Hainan Island.

4. As reported in the 2008 document from the Ministry of Commerce and the Ministry of Finance, "Temporary methods to manage the development funds for overseas economic cooperation zones." These were, however, defined as "tentative" in the document; and the actual incentives package being executed has not been confirmed by the Ministry of Commerce.

5. This enhanced access would be phased in, starting at 60 percent in 2010.

6. The Chambishi Zone is a mining and minerals-processing project that began in 2003. A subzone of Chambishi, designed for traditional light manufacturing industries, is now under planning and construction near Lusaka.

7. The mining activities and the CNMC subsidiaries are not technically considered part of the zone.

About the Authors

Deborah Brautigam *is Associate Professor at the School of International Service, American University, Washington, DC.* Thomas Farole *is Senior Economist, International Trade Department, World Bank, Washington, DC.* Tang Xiaoyang *is a doctoral researcher at the New School for Social Research, New York.*

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