

**SPECIAL ECONOMIC ZONES**

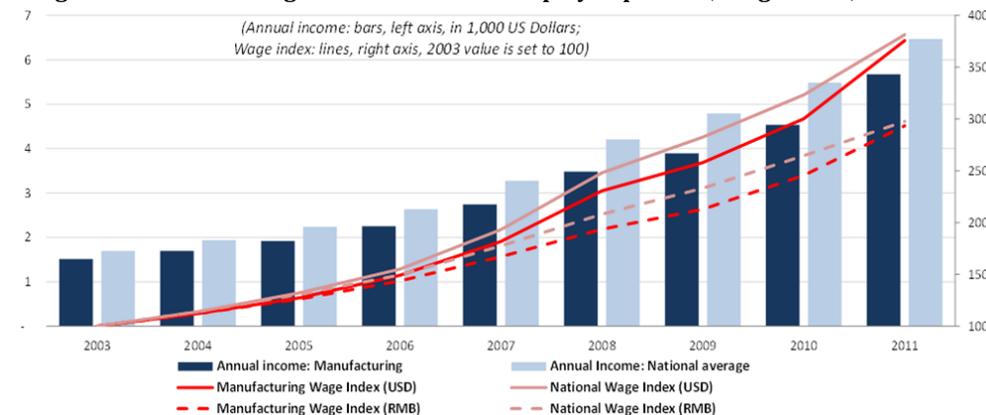
Labour costs in China have risen steadily in recent years, particularly in low-skilled manufacturing sectors. This trend has stimulated interest in where these low-skilled manufacturing jobs might go, and whether their relocation suggests opportunities for industrialisation in low income countries. This expectation is informed by the experience of some East Asian economies where relocated production of labour intensive manufacturing activities supported economic growth and development. Special Export Zones (SEZs) were important to the strategy of these economies in making themselves an attractive investment destination for firms looking to relocate, and many economies in sub Saharan Africa have increased their experimentation with this model since the 1990s. **This issue brief considers the similarities and differences between the experiences of SEZs in Asia and Africa.**

**Fig.1** illustrates the rapid increase in average manufacturing sector wages in China over the past decade. Between 2003 and 2011, the national per capita income nearly quadrupled from US\$1,696 to US\$6,469. Wages in the manufacturing sector have taken on similar upward trend, increasing more than threefold from US\$1,510 in 2003 to US\$5,674 in 2011. Since China released its currency's hard peg to the US dollar in 2005, the continuing appreciation of RMB has also meant that income denoted in USD has increased more rapidly than income denoted in RMB. This exchange rate effect has further increased wage costs for foreign investors.

This trend of wage increases resembles that of Japan in 1970s and the 'Asian Tiger' economies in 1980s. Rising wages in labour intensive sectors, first from Korea and Japan, and later from Singapore, Taiwan and Hong Kong stimulated the relocation of production to countries where wages were lower at that time, such as China. As labour-intensive, low-skilled manufacturing economies began to mature, they experienced an overall increase in their skill profile, through *inter alia* technology transfer, 'learning by doing' and investment in education. The supply of unskilled labour became less abundant and wages in these economies increased. Over time, these increases stimulated shifts in their factor endowment structure as skilled labour became more abundant. The production structure of the overall economy moved away from labour intensive, towards skill-intensive and capital-intensive activity, and labour intensive manufacturing firms looked to exit. This experience informs the promotion of the idea that the current process of structural transformation in China, and in particular its domestic industrial upgrading, suggests a 85 million job 'bonanza' for sub Saharan Africa.

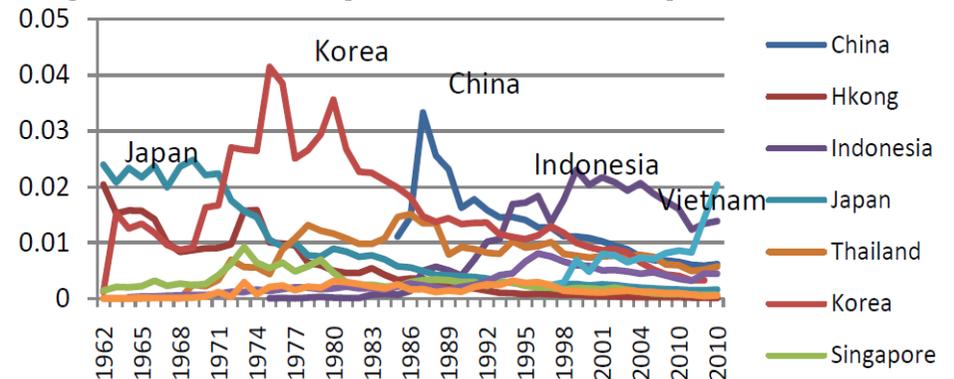
**Fig.2** illustrates the relocation of labour intensive industries that has occurred in East Asia. It provides the share of textile exports from particular East Asian economies between 1960s and 2000s. These peaked sequentially first in Japan in late 1960s, Korea through out 1979, China in early 1990s, Indonesia in early 2000s, and Vietnam has started to pick up closer to 2010. Similar trends can be observed in sectors such as clothing, shoe and toy manufacturing.

**Figure 1: China's average annual income of employed persons; Wage index, 2003-2011**



Source: China's National Bureau of Statistics; People's Bank of China

**Figure 2: Share of textile exports in total merchandise exports**



Source: Chandra, Lin and Wang (2012)

The creation of Special Economic Zones (SEZs) in many East Asian economies is closely associated with their success in attracting investment and its effects on their economic transformation. There are a range of concepts often used interchangeably with SEZs, such as export processing zones (EPZs), industrial development zones (IDZs), free trade zones, free ports etc. Although operational details differ, zone programs look to attract increased capital investment, particularly Foreign Direct Investment (FDI) by ensuring that within these zones, firms are subject to more business friendly administrative, regulatory and fiscal regimes. These can include preferential rules regarding investment conditions, international trade and customs, and taxation.

The success of SEZs can be assessed across two dimensions:

1. **Their short term effects** through increased investment, exports and employment;
2. **Their longer term effects** on the structure of economic activity.

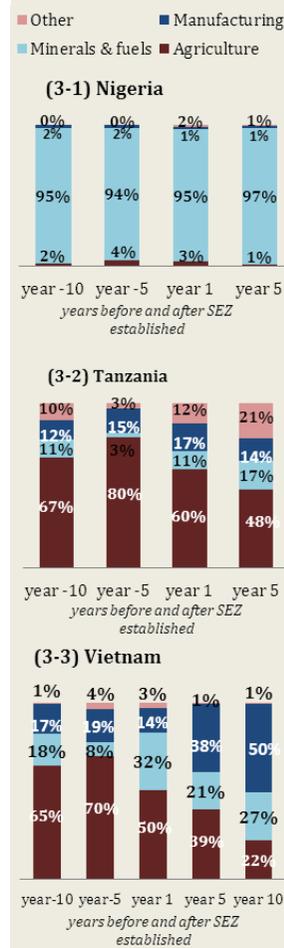
To have a longer term or economic development effects the experience of East Asian economies suggests that there needs to be increased linkages between zone-based activities and the local industries, skills and technology transfer, as well and dynamism within and between firms enabling movement up value chains.

China's experience with SEZs to attract investment supporting their economic transformation is widely recognized as among the most successful examples of the use of SEZs to create a differential business environment. The first zones in China were established in 1978 and it is estimated that between 1979 and 1995, 40% of FDI to emerging economies went to China of which 90% went to the coastal areas and more than a quarter went to three SEZs in Guangdong. There are now more than 200 zones of different types, sizes and sectoral concentrations in China. Since the 1990s, a growing number of Sub-Saharan African economies have increased their experimentation with SEZs. There have also been World Bank projects to support increased exchange or shared experience between Asian and African economies arranged within a broader framework of 'south-south cooperation'. These are frequently sponsored by groups of investors from East Asia such as the Enterprise Institutes of Singapore and Malaysia and similar structures in China.

There are however distinct differences in the structure and composition of established SEZs in Africa, Asia and Latin America. The World Bank (2011) identifies

that while some **SEZs in Africa have attracted large initial investment (short term effects), they are underperforming in the longer term growth and development effects anticipated.**

**Figure 3: Composition of National Exports**



Source: World Bank 2011

This can be assessed by at least two sets of measures. **Investment measures** show that African SEZs host relatively small numbers of firms, no more than 35 on average. This is in marked contrast to SEZs in countries such as Bangladesh, which support close to 300 firms, or Vietnam, which host more than 3,500 firms. **Export measures** show that African countries hosting SEZs have seen little to no structural shift in the composition of their exports. **Nigeria's** export structure has shown no change (fig 3-1). There is a slightly better trend in **Tanzania** which has in the period after the creation of its SEZ programme seen a decrease in primary exports in the agriculture sector, an apparent consolidation of manufacturing exports, and a rise in services exports (fig. 3-2). In **Vietnam**, a country for which there is comparable experience over a longer period, the shift into production of higher value goods seems to be consolidating (fig 3.3). Explanations for these differences include that countries in sub Saharan Africa experimenting with SEZs face a different external environment than that which prevailed in the decades from the late 1970s to the 1990s. Another explanation is that African SEZs reflect the existing comparative advantage of their economies. So far, the main investment into African SEZs has been in capital- and resource-intensive sectors, while East Asian SEZs have captured labour intensive activities. The latter have a lower capital threshold for new entrants, and stronger linkages with other labour-intensive sectors. These characteristics

are likely to have supported the expansion of the *number* of firms in these SEZs, which have grown exponentially over time. This experience suggests that for SEZs to deliver on expectations of both short term investment effects and longer term development effects it is not only their presence but design that matters.