

# Special Economic Zones in Fragile Situations: A useful policy tool?



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AFRICAN DEVELOPMENT BANK GROUP

**Transition Support  
Department**



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Africa has witnessed impressive growth rates over the past decade. The continent has also become the world's fastest-growing region for foreign direct investment (FDI). While global FDI fell by 16 per cent in 2014, foreign investment to Africa remained stable at USD 54 billion. Maintaining the continent-wide level of investment is all the more remarkable, as North Africa experienced a 15 per cent decline that was offset by sub-Saharan Africa, notably thanks to significant FDI increases in Central and East Africa.

In general, trends in FDI flows tend to reflect the level of confidence investors have in political and economic conditions within countries. Within limits, it can therefore serve as a barometer of a country's perceived stability, both in political, economic and social terms, and to what extent it is believed that governments and investors have the capacity to manage potential risks. The surge in violent conflict in West Africa and the Ebola outbreak exposed the capacity weaknesses of several states to effectively confront these challenges, and contributed to a decline in the sub-region's foreign investments of 10 per cent in 2014.

The prevalence of peace and stability is, therefore, a key driver for investment and economic growth. The concentration of FDI inflows in a small number of countries – in 2014, the top five recipients received about as much FDI as the remaining 49 countries together – is testament to the selectivity and rationale of investors. Infrastructure and the regulatory environment are often cited as main challenges in this regard.

In view of these challenges, African policy makers are increasingly set on solutions that hold the promise to address these challenges. In this context, the establishment of Special Economic Zones (SEZs) is gaining increasing attention and consideration across the continent as a policy tool, notably in countries facing fragile situations. The promise of a separate set of rules in a demarcated geographic area is particularly appealing for countries with big infrastructure deficits and a complex policy arena where progress on the business environment is slow.

However, setting up such zones is a complex endeavor and Africa's own experience has shown the risks and costs of failure - even in rather stable environments. As Africa's premier financing development institution, the African Development Bank Group (AfDB) has therefore commissioned this report to shed light on the opportunities and risks associated with the establishment of such SEZs in fragile contexts.

The report provides important insights and recommendations on the topic that are relevant both for policy makers and development partners, as they strive to attract a greater share of foreign investments to unlock the development potential in these countries.



Janvier K. Litse  
Acting Vice President, ORVP



The Strategy on Addressing Fragility and Building Resilience in Africa (2014-2019) guides the engagement of the African Development Bank Group (AfDB) in fragile situations. In line with international thinking and our own experience, we recognize that fragility has multiple sources – economic, political, social and environmental – and is not limited by state boundaries.

In our strategy we have come to recognize fragility to be “a condition of elevated risk of institutional breakdown, societal collapse or violent conflict”. This risk can appear at the national, sub-national or regional level. In light of this understanding, we have moved away from the concept of a list of fragile “states” to a more nuanced approach of fragile “situations”.

It is becoming increasingly clear that economic growth and private sector-led job creation play an important role in building resilient states. Attracting foreign direct investment (FDI), facilitating economic linkages, ensuring diversification, and other forms of private sector development are therefore key aspects to mitigate fragility. However, the political economy of countries experiencing fragile situations is particularly complex and challenging, as governance deficits can exacerbate economic, environmental and social crises – and vice versa.

The Transition Support Department (ORTS) was established to support the Bank’s commitment to play a leadership role on issues of fragility and contribute to the international debate around how to address fragility and build resilience in Africa. As Special Economic Zones (SEZs) are an increasingly popular strategy to attract FDI to fragile situations, it is timely to assess the opportunities and risks associated with this approach and analyse to what extent and under which conditions SEZs can live up to their promise and become a catalyst for private sector development and foreign investment in these environments.

The report contrasts the theory of developing SEZs with evidence from existing experience (more often than not of unfulfilled promises), identifying problems of weak governance and instability as particular constraints. Seeing as though issues of institutional capacity and volatility are characteristic of fragile situations, implementing an SEZ programme is all the more challenging in those contexts. The risks of pursuing an SEZ approach for the wrong reasons, based on political rather than economic considerations, is more prevalent in fragile situations where policymakers under enormous pressure to show quick results. However, the resulting risk that SEZs thus disappoint raised expectations in the population and damage investor confidence is often overlooked.

The main lessons emanating from this study are that i) SEZs require a minimum level of state capacity, ii) SEZ policy design and implementation is a lengthy and difficult process, iii) there is an increased threat that SEZs in fragile situations may fall captive to vested interests, iv) meaningful private sector participation is even more important in fragile situations.

Building on its comparative advantage as a ‘trusted advisor and honest broker’, the study urges the AfDB to systematically advise and support governments, notably when in fragile situations, as to whether or not, and how, to establish SEZs. This topic should be high on our agenda for policy dialogue with concerned governments, private sector and development partners from the initial stages to avoid pitfalls from the past. SEZs can present significant opportunities to support economic growth and create jobs in fragile situations, but only if the business case is strong and the political economy supportive.



Sibry Tapsoba  
Director, ORTS

## Acronyms and abbreviations

<b>AfDB</b>	African Development Bank Group
<b>CSIS</b>	Centre for Strategic and International Studies
<b>EPZ</b>	Export-processing zone
<b>FDI</b>	Foreign Direct Investment
<b>IFC</b>	International Finance Corporation
<b>ILO</b>	International Labour Organization
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>ORTS</b>	Transition Support Department (AfDB)
<b>PSD</b>	Private Sector Development
<b>SEZ</b>	Special Economic Zone
<b>UNCTAD</b>	United Nations Conference on Trade and Development

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## Executive Summary

This study seeks to provide insight into the role and potential of the Special Economic Zone (SEZ) as a development strategy in African fragile situations. It seeks to investigate to what extent and under which conditions SEZs – that are gaining increasing attention by policy makers in these environments – may act as a catalyst for private sector development and foreign direct investment (FDI). Based on a comprehensive desk review with additional country research conducted on the experience of SEZs in Zimbabwe, the Democratic Republic of Congo and Côte d'Ivoire, the study provides recommendations to the African Development Bank Group (AfDB), as Africa's premier development finance institution, both at the corporate and country-level, to assist fragile economies that consider establishing SEZs as part of their development strategy.

AfDB's recently approved strategy to address fragility and build resilience in Africa (2014-2019) is based on an understanding of fragility as a "condition of elevated risk of institutional breakdown, societal collapse or violent conflict." Accordingly, drivers of fragility include economic, social, political and environmental dimensions. While there is no internationally agreed definition of what constitutes a 'fragile situation', it is recognized that addressing these challenges is of critical importance for the post-2015 development agenda, particularly in Africa. With the increasing international emphasis on facilitating private sector investments to support inclusive growth in the post-2015 development agenda, fragile situations need particular attention, as only 6% of FDI to developing countries in 2012 went to fragile situations and it was concentrated in just ten resource-rich countries. In this context, SEZs are attracting attention from policy makers and international development partners as an economic policy tool to increase investments in fragile contexts.

While SEZs have been the subject of several generic studies, it is important to better understand the objectives, potentials and risks involved when establishing SEZs in fragile situations and their contribution to addressing drivers of fragility and strengthening sources of resilience.

SEZs can be broadly defined as demarcated geographical areas within a country's national boundaries where the rules of business are different – generally more liberal – from those that prevail in the rest of the national territory. They thus appear particularly attractive in fragile contexts that are marked by a particularly challenging environment to do business. Specifically, most zones confer four main advantages to investors relative to what they could normally receive in the domestic environment: infrastructure, an improved regulatory and administrative regime, a special customs regime, and an attractive fiscal regime.

This paper identifies seven principal ways in which SEZs can meaningfully contribute to the socio-economic development in fragile situations, addressing drivers of fragility and building resilience:

- 1 **Attracting foreign direct investment:** SEZs can present investors with a more attractive investment offer in fragile situations, including through improved security (both economic and physical), support for local financial intermediation, improved access to serviced land and/or buildings and protection of land rights, catalysing the rebuilding of the business environment, linkages to local economies, and reliable electrical supply. For example, in Ghana, FDI into SEZs represented 48% of total national FDI between 2000 and 2008.
- 2 **Establishing growth poles:** A recent trend in Africa presents governments of countries affected by fragile situations with the possibility of using SEZs as growth poles, i.e. integrated regional growth initiatives based on domestic industry clusters and local labour markets and around key trade infrastructure (ports, roads, power projects). This allows governments to better integrate their national economies, thus addressing drivers of fragility such as economic exclusion, unemployment and regional instability. By way of example, in Côte d'Ivoire, the government is currently planning three SEZs around regional centres of economic growth, including near Bouake, a city that was at the epicentre of the recent political crisis.
- 3 **Encouraging private sector participation:** Additionally, successful SEZs depend on private sector participation in the management of the zone, which can also lead to a broader engagement of the private sector in the economic, social and political development of countries affected by fragile situations. For instance, in Nigeria, many recent zone projects are Public-Private Partnerships.
- 4 **Supporting SMEs:** SEZs also have the potential to support local SMEs by either encouraging them to enter the zone directly by lowering entry costs or facilitating these local companies becoming suppliers to firms in the zone by making procurement processes easier and more competitive. Hereby, SMEs can become catalysts for a broader entrepreneurial culture. The SEZ authority in Kenya for, example, established an incubator programme to help SMEs establish direct exporting and subcontracting linkages with firms in the zone. In Mauritius, extensive linkages between Export Processing Zone firms and SMEs have long been established.
- 5 **Catalysing wider private sector development by focusing on competitive subsectors or projects:** Successful SEZ programmes in the past have targeted specific sectors and investors with a potential to become a catalyst for wider private sector development. This allows governments to address sector-specific economic, political and social sensitivities with a view to improving the governance environment that is an essential part of building resilient economies and societies.
- 6 **Supporting economic diversification:** SEZs – and particularly those that are mixed-use zones – can provide an avenue for a gradual emergence of a services and export-oriented manufacturing sector. For example, Mauritius' export-

processing zone (EPZ) contributed to a diversification away from sugar exports to the clothing and services sectors. The resource curse associated with the dependence on a specific natural resource has been identified as a main characteristic in many fragile situations in Africa.

- 7 **Attracting more multilateral support:** International development finance institutions are now more readily providing support for the creation of growth pole SEZs.
- 8 **Fostering institutional collaboration and policy coherence:** A successful SEZ programme requires extensive regulatory and institutional coordination. If implemented successfully, this can strengthen institutions' capacity and skills in the specific task it is assigned in the process of developing and implementing an SEZ strategy. Additionally, efficient zone management requires a significant collaboration between different institutions and non-state actors. Such collaboration helps foster policy coherence, policy stability, and, ultimately, state capacity. Indeed, effectively addressing fragility and building resilience requires state capacity and the collaboration of all stakeholders, including governments, the private sector, civil society, and donors.

SEZs thus have the potential to have positive static impacts in fragile situations in terms of attracting FDI and creating employment, but also in terms of dynamic impacts with regards to creating linkages with the national economy, ensuring diversification and addressing governance deficits.

While the theory thus shows that SEZs have the potential to be a useful tool for economic growth in fragile situations, in practice, SEZ programmes in African fragile situations exhibit a number of challenges. The evidence from zone programmes in the whole of Africa – not only in fragile situations – suggests that problems of weak governance and instability have played an important part in such programmes' ineffectiveness to date. Seeing as though issues of institutional capacity and volatility would most likely be exacerbated in fragile situations, implementing an SEZ programme could be all the more challenging in those contexts.

Observations from the initial stages of policy design and formulation in Zimbabwe's SEZ programme appear to confirm this hypothesis: A lack of policy clarity, politicized decision-making and absence of ownership due to insufficient technocratic capacity present significant hurdles to the ambitious programme. It seems that governments experiencing policy crises almost reflexively set their sights on SEZs as a panacea to political and economic problems. They underestimate the institutional coordination and ownership that a successful SEZ policy formulation and implementation requires. When the choice of SEZs is made based on imminent political-economic pressures, the process is flawed from inception, as governance deficits subsequently exacerbate the problems that come with an inadequate preparation. There is a resulting risk that SEZs thus disappoint raised expectations in the population and damage investor confidence.

This paper identifies a number of lessons learnt in this regard, drawing from the experience of providing technical assistance by the AfDB to the Government of Zimbabwe and existing experience in other fragile situations: i) SEZs require a minimum level of state capacity, ii) SEZ policy design and implementation is a lengthy and difficult process, iii) there is an increased threat that SEZs in fragile situations may fall captive to vested interests, iv) meaningful private sector participation is even more important in fragile situations.

- As Africa's premier development finance institution, the AfDB could build on its comparative advantage as a 'trusted advisor and honest broker' to advise and support governments in fragile situations as to whether or not, and how, to establish SEZs. This would contribute significantly in closing a critical gap in the development financing architecture for the post-2015 era. Against this background, the paper argues that it is timely for the Bank to assume leadership in this particular area and it makes the following specific recommendations to be considered by the Bank's management based on the findings of this study. On the corporate level, the AfDB should consider the idea of developing SEZs in fragile situations as one part of its toolkit to address fragility and build resilience in Africa, since SEZs can catalyse wider positive economic, social and political impacts beyond the zone itself. Country Strategy Papers and Regional Integration Strategy Papers should explicitly analyse the potential of establishing SEZs and put this topic on the agenda for policy dialogue with concerned governments, private sector and development partners. This should be complemented by targeted technical assistance to support the development of SEZ programmes, investments in transport infrastructure, and using intermediary firms to serve as investment facilitators, all of which support the successful implementation of the programme.
- At the country level, AfDB should focus on the following key issues when assisting the development of an SEZ programme: (i) political economy diagnostic; (ii) emphasizing the preparatory phase of SEZ programmes; (iii) ensuring a parallel regulatory track; (iv) encouraging private sector participation; (v) outlining the constraints; (vi) reaching out to stakeholders; (vii) supporting the establishment of steering committees; and (viii) providing the necessary neutral guidance.

## 1 Introduction

Despite a poor track record of past export processing zones in Africa, Special Economic Zones (SEZs) are currently becoming popular as an economic policy tool in the continent's 'states in fragile situations': At least 14 SEZs or SEZ programmes are currently planned in 11 out of 17 African states that figure on the harmonized list of fragile situations in 2014 compiled by multilateral development banks.

In line with the evolving understanding of what constitutes fragility, multilateral institutions such as the African Development Bank Group (AfDB) and the OECD are increasingly adopting different approaches that focus on addressing drivers of fragility while strengthening sources of resilience. This implies moving away from a state-centric model of lists of 'fragile states' to address drivers of fragility that are present to varying degrees in all countries. Given that governments of countries experiencing fragile situations increasingly are considering or choosing SEZs as an economic policy tool, there is urgency in understanding the objectives, potentials and risks of establishing SEZs in fragile situations to ensure that such zone programmes can succeed in fragile situations and contribute to mitigating drivers of fragility. This is particularly important given that SEZ programmes require significant investment in administrative, fiscal and financial capital.

This paper seeks to provide insight into the role and potential of the SEZ instrument in fragile situations in Africa and the obstacles that constrain the successful use of this tool in such situations. It then proceeds to offer concrete recommendations to help strengthen the AfDB's and other development partners' engagement in this field at both a country and corporate level in the context of the Bank's recently approved strategy for "Addressing Fragility and Building Resilience in Africa (2014-2019)". The key audience is thus the AfDB and other development partners operating in this space. It is important to note that this paper presents the evidence so far, and by no means attempts to draw a final conclusion on the role and potential of SEZs in fragile situations in Africa, seeing as though there is insufficient empirical knowledge on this more recent phenomenon. For many African zone programmes, it may be too early to pronounce on their definitive success or failure, as most zones take 5-10 years to bear fruit.

## Methodology

The analysis in this paper is based on an extensive literature review on SEZs in Africa and the consultation of SEZ experts with experience in delivering technical assistance in designing and implementing SEZ programmes in Botswana, Côte d'Ivoire, the Democratic Republic of Congo, Ethiopia, Lesotho, Mali, Mauritania, Mauritius, Togo, Senegal and South Africa, as well as in numerous countries outside of Africa. Furthermore, lessons learnt from a 2014 technical assistance project by the AfDB to the government of Zimbabwe complemented this study.

An important caveat is the lack of data and studies on SEZs in Africa. Thomas Farole's 2011 study remains the most extensive and most up to date summary of SEZs on the continent and its conclusions remain valid. Updating existing information and filling gaps in data should therefore be a priority for further policy research.

## 2 The political economy of fragility

Addressing fragility is widely recognised as a core challenge to achieving the upcoming Sustainable Development Goals that will replace the Millennium Development Goals. It features prominently on the agendas of development partners, governments and academics. While there is no internationally agreed definition of what constitutes fragility, the topic has been gaining attention from policy makers in various fields, linking issues of security and peace to broader development efforts. Already in 2004, Francis Fukuyama noted, "Since the end of the Cold War, weak and states in fragile situations have arguably become the single-most important problem for the international order".<sup>1</sup>

### Understanding fragility

It is recognised that fragility poses a particular challenge for Africa in the post-2015 development agenda. Over the past decade, the continent as a whole has seen expanded economic opportunities and improved societal conditions, yet, significant risks to stability threaten to undermine this momentum. According to the AfDB, currently, more than 250 million Africans are affected by fragility, with significant regional spillover effects. These pressures are especially present in the Horn of Africa, the Sahel, the Mano River Union, and the Great Lakes and Central Africa region.

Fragility manifests itself in different forms and shapes across the continent. For instance, in the Horn of Africa and the Sahel, environmental dimensions around conflicts over resources are very important drivers of fragility. The social dimension is a critical challenge in almost all countries, where ethnic, tribal, and other tensions present a conflict potential. Seth Kaplan (2014) further alludes to the social dimension of fragility by pointing to populations' lack of capacity to cooperate in pursuit of public goods, leading to what he calls a "political-identity fragmentation."<sup>2</sup>

The economic dimension of fragility and weak governance remains prevalent. For instance, most fragile economies on the continent are small and isolated due to inadequate transport infrastructure, while governments lack the resources to improve the situation. In the African countries with small markets, economies of scale and competition are hindered, while the global market is mostly inaccessible.<sup>3</sup> In addition, many African economies are highly dependent on extractive sectors that operate as

<sup>1</sup> Fukuyama, F. 2004. *Statebuilding: Governance and World Order in the 21st Century*. Cornell University Press.

<sup>2</sup> Kaplan, S. 2014. "Identifying Truly Fragile States." *The Washington Quarterly*.

<sup>3</sup> Collier, P. 2014.

enclaves. Such an over-reliance often inhibits job creation, economic inclusion and good environmental policies, which can constitute drivers of fragility. Furthermore, it is also closely linked to governance weaknesses and affects the nature of state-society relationships and the overall economic decision-making apparatus, as governments principally focus on extracting rents from these resources and neglect other economic sectors.

In sum, the political economy of African countries experiencing fragile situations is particularly complex and challenging, as governance deficits exacerbate economic, environmental and social crises – and vice versa.

The AfDB's strategy to address fragility and build resilience in Africa (2014-2019) acknowledges the multi-dimensional nature of fragility and defines it as a condition of elevated risk of institutional breakdown, societal collapse or violent conflict. Recognising that fragility does not respect state boundaries and drivers of fragility are present in all countries, the strategy focuses on fragile situations rather than fragile states as such. Fragile situations are highly context-specific and may occur at national, sub-national or regional levels. Recognising this complexity, the AfDB's approach is based on three main premises:

- Drivers of fragility include economic, social, political and environmental dimensions.
- The drivers of fragility are caused by the real or perceived “exclusion of a category of citizens from services, resources, opportunities or rights.”
- Characteristics, manifestations and threats of fragility and the capacities and resources of affected states and societies vary significantly.<sup>4</sup>

## The role of the state in fragile situations

The High-Level Panel on Fragile States that was established by the AfDB views fragility as a product of dramatic social, economic and environmental change. Fragility occurs when these changes become too great for governments to manage, creating a risk that conflict spills over into violence. Countries that lack robust institutions and inclusive political systems are the most vulnerable to fragility. At the same time, the resulting drivers of instability further erode the state capacity needed to manage them.<sup>5</sup> In escaping this ‘fragility trap’, strengthening capable and legitimate institutions is essential to avoid social exclusion, ensure justice and peace, and ensure economic resilience.

The observation that the state acts both as manager and impediment to mitigating drivers of fragility is particularly important in the context of this paper, as SEZs require a minimum level of state capacity to introduce reforms in a limited geographical area despite the limitations that might exist on a national scale.

<sup>4</sup> AfDB. 2014. “Addressing Fragility and Building Resilience in Africa.”

<sup>5</sup> AfDB. 2014. “High Level Panel on States in fragile situations, 2014, Ending conflict & building peace in Africa - A call to action.”

## The economic dimension of fragility

The economic dimension of fragility is important in as much it is recognized that the strength of the economic recovery is crucial in avoiding a cycle of war and underdevelopment.<sup>6</sup> The AfDB highlights contributing factors such as inequality (principally income inequality), growing informality of the economy, economic exclusion, and natural resource conflicts.<sup>7</sup> Economists like Paul Collier see the economy as a source of fragility due to low income levels, the frequent looting of valuable assets, and extreme volatility.<sup>8</sup> Additionally, the “New Deal on Engagement in States in Fragile States” and the 2011 World Development Report emphasise the role of economic foundations and the creation of employment opportunities as important entry points to support inclusive growth in fragile situations. Since public institutions often lack the ability and revenue to absorb the large numbers of job seekers that enter the labour market, the private sector is gaining increasing attention as the source of job creation. Thus, it is becoming increasingly clear that economic growth, the private sector and foreign direct investment (FDI) have an important role to play in addressing fragility and building resilience. Attracting FDI, facilitating economic linkages, ensuring diversification, and other forms of private sector development (PSD) are key strategies to mitigate fragility.

While this is true, it is also the case that the inverse relationship between fragility and the economy may develop, whereby existing conditions at the regional, national or local levels may present significant hindrances to investment and economic activities. In the worst forms, overt conflicts will actively lead to the destruction of economic activities and capital, driving the private sector away. This is a key aspect of the fragility trap.

## FDI in fragile contexts

A number of distinctive aspects of fragile economies constrain their scope for significant FDI. As Paul Collier (2014) points out, most fragile economies are both small and isolated due to inadequate transport infrastructure. Their governments generally lack the resources to break out of this trap. Additionally, the domestic market is generally small and the global market inaccessible. Small market sizes inhibit economies of scale and weaken competition, which could force both static (employment, investment, exports, etc.) and dynamic (linkages, technology, etc.) gains in efficiency. Beyond these exogenous factors, systemic failures cause an information asymmetry between outside investors and entrepreneurs seeking investment. A Centre for Strategic and International Studies (CSIS) report identified information asymmetry as one of the major obstacles

<sup>6</sup> OECD. 2012. “Growth, aid and policies in countries recovering from war”.

<sup>7</sup> AfDB. 2014. “High Level Panel on States in fragile situations, 2014, Ending conflict & building peace in Africa - A call to action.”

<sup>8</sup> Collier, P. 2014. “States in fragile situations: What Should Donors Do?”. Fondation pour les Études et Recherches sur le Développement International.

to investment facilitation in transitional and states in fragile situations. Thereby, outside investors assume they are at a significant operational and international disadvantage in the market, while entrepreneurs assume they are at a significant informational disadvantage when seeking investment.<sup>9</sup> Thus, fragile economies, to a great extent, rely on pioneer investments that generate significant externalities but remain insufficient for a substantial improvement of the overall investment climate.

Based on data from the United Nations Conference on Trade and Development (UNCTAD), the 17 African countries on the harmonized list of fragile situations in 2014 receive only 16.7% of the continent's total FDI inflows in 2013 (see Table 1). About half of these figures go to the resource-rich countries of Sudan and the DRC. The OECD confirms these observations by finding that only 6% of FDI to developing countries in 2012 went to fragile situations and was concentrated in just ten resource-rich countries.<sup>10</sup>

**Table 1** FDI inflows, by region and economy, 2014

Region / economy	FDI inflows (USD millions)	Percentage of FDI inflows into Africa
Africa	57 238.8	
Sudan	3 094.4	5.41%
Congo, Democratic Republic of the	2 098.2	3.67%
Liberia	1 061.3	1.85%
Libya	702.0	1.23%
Sierra Leone	579.1	1.01%
Chad	538.4	0.94%
Mali	410.3	0.72%
Zimbabwe	400.0	0.70%
Côte d'Ivoire	371.0	0.65%
Somalia	107.1	0.19%
Togo	84.2	0.15%
Eritrea	43.9	0.08%
Guinea	24.8	0.04%
Guinea-Bissau	14.5	0.03%
Comoros	13.9	0.02%
Burundi	6.8	0.01%
Central African Republic	0.8	0.00%
Total (excl. Africa)	9 550.7	16.70%

Source: UNCTAD, FDI/TNC database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

<sup>9</sup> Cusack, J. and Tilleard, M. 2013. "Investment Facilitation in Transitional and States in fragile situations." Centre for Strategic and International Studies (CSIS) Project on Prosperity and Development.

<sup>10</sup> OECD. 2015. "States of Fragility 2015: Meeting Post-2015 Ambitions."

## The “comparative advantage” of fragile economies

However, seeing as though fragile economies are particularly challenging and more mature African countries exist, the question remains why investors would consider investing in countries facing fragile situations at all. Above FDI flows show that these investments are happening, albeit at a lower level compared to countries not affected by issues of fragility. The main opportunities for domestic and foreign investors in fragile economies are untapped natural resources, reconstruction needs, and severely underserved consumer demand.<sup>11</sup> This first mover advantage is seized by a growing number of companies around the world, as UNCTAD data shows that FDI flows into states that figure on the harmonized list of fragile situations grew at a compound annual rate of 12% in 2013, compared to 4.5% in the rest of the world – albeit from a low base. Facilitating and promoting investments in fragile situations is therefore an important part of the international agenda to build resilience in Africa.

### 3 The theory: Why SEZs are attractive in fragile situations

#### 3.1 What are SEZs?

Special Economic Zones can be defined as demarcated geographical areas within a country’s national boundaries where the rules of business are different – generally more liberal – from those that prevail in the national territory. Specifically, most economic zones create a ‘special’ regime that confers four main advantages to investors relative to what they could normally receive in the domestic environment:

- 1 **Infrastructure** (including serviced land, factory shells, and utilities) that is easier to access and more reliable than is normally available domestically;
- 2 **An improved regulatory and administrative regime**, including streamlined procedures for company set-up, licensing, and operations; and usually,
- 3 **A special customs regime** including efficient customs administration and (usually) access to imported inputs free of tariffs and duties;
- 4 **An attractive fiscal regime**, including reduction or elimination of corporate taxes, VAT, other taxes, labour contributions (e.g. pension / social security), and sometimes training or other subsidies.

It is critical to understand the goal and purpose of SEZs in their economic and policy context. In this sense, it is useful to view SEZs as not simply a more liberal environment but as a form of ‘packaged competitiveness’. This package is delivered through the

<sup>11</sup> UNCTAD. 2014. “World Investment Report 2014: Investing in the SDGs: An Action Plan.”

combined offering of regulation, governance and infrastructure which form a concentrated set of assets: (i) a regulatory regime that enhances the business climate and decreases the cost of doing business; (ii) an efficient governance structure that provides a solid development strategy and implementation, ensures effective performance of the regime, and supplies responsive zone management; and (iii) a strong infrastructure offering combining world class business/technology/ industrial/commercial park(s) and transport nodes.

In this understanding,

*Special economic zones represent a policy concentrate designed to increase growth by creating an economic environment, which offers significantly better investment, and operating conditions than the rest of the domestic economy, and ensure that conditions of international competitiveness are created. Under optimal conditions of strategy, design, location, factors endowment, regulation and governance, SEZs have proven their capacity to generate significant economic benefits*<sup>12</sup>.

Thus, SEZs are no longer simply a set of special incentives and potential welfare-negative incentives throwing states into a race to the bottom. Incentives, while remaining an important element of the competitive equation, are but one, and not necessarily the critical, element of the package.

SEZs come in a number of distinct forms, such as an export-processing zone (EPZ), an industrial zone, or a free port. For the purpose of this paper, 'SEZs' will denote the type of second generation zone in Africa that seeks to foster both positive static and dynamic impacts<sup>13</sup>, while establishing a so-called 'growth pole', thereby acting as a catalyst for wider investment climate reform and economic growth. It is thus a different concept than an EPZ, which represents an export-only zone programme that largely ignores the potential of economic linkages of a zone with the national private sector.

In the 1960s and 1970s, EPZs – enclaves focused exclusively on export markets and restricted to foreign capital – contributed to a great extent to the emergence of the newly industrialised countries of East and South East Asia, South Korea and Taiwan-ROC. The rapid growth of such zones was due to an unprecedented era of globalisation of trade that took place in the 1980s and 1990s.

Based on FIAS<sup>14</sup> and ILO data, SEZs today may account for 130 million jobs worldwide, approximately 7-8 % of total global exports and slightly less than 20 percent of exports

<sup>12</sup> Baissac, C. 2010. "SEZs for South Africa."

<sup>13</sup> Static impacts refer to figures such as investment, employment, and exports. Dynamic impacts represent changes in the economic structure of the host economies by encouraging private sector-led growth, fostering the growth of non-traditional manufacturing and service activities, and encouraging the linking of national companies to the value chains of foreign investors.

<sup>14</sup> The Foreign Investment Advisory Service (FIAS) is a multi-donor investment climate advisory service managed by the World Bank.

from emerging and developing economies.<sup>15</sup> A recent Economist article projects that there could be 5,000 SEZs worldwide “before long”.<sup>16</sup> This evidence suggests that SEZs account for a significant share of FDI and exports, and that their number will increase in the near future.

### 3.2 The potential role of SEZs in fragile situations

There is merit in considering SEZs as a useful economic policy tool in fragile situations. In fragile contexts, SEZs have the potential to not only attract FDI and create employment, but also to mitigate some of the characteristics of fragile situations and address some underlying drivers of fragility. Because SEZs are generally focused on a limited geographical area within a particular country, they provide an opportunity for limited but nevertheless strongly concentrated level of institutional capacity and determined state action. They can be a useful policy tool in fragile situations to overcome some of the structural deficits, in particular in terms of attracting investment, diversifying economies, and ensuring collaboration between stakeholders.

#### 1 Attracting FDI

The primary role of SEZs in fragile situations in Africa is the attraction of FDI. SEZs provide the opportunity in fragile situations to take into consideration investor preference and overcome investment climate deficits by presenting potential investors with a more attractive offer in a focused geographic area. The SEZ, if managed properly, provides a business environment that is not hamstrung by the inefficiencies of the regular economy. Thus, a zone programme can provide a unique offering in fragile situations, including:

- Improved security (both economic and physical) and minimising risk of loss for investors;
- Support for local financial intermediation;
- Improved access to serviced land and protection of land rights;
- Catalysing the rebuilding of the business environment (in countries where this is applicable);
- Investor-friendly regulations;
- Linkages to local economies; and
- Reliable electrical supply.

One successful example for such a process is Ghana, where the ‘special’ conditions within this zone helped overcome some of the broader business environment problems: Between 2000 and 2008, FDI into SEZs in Ghana represented 48% of total national

<sup>15</sup> For a more detailed explanation of these figures, see Claude Baissac, “Brief History of SEZs and Overview of Policy Debates” in Thomas Farole, *Special Economic Zones in Africa*, 2011.

<sup>16</sup> “Special Economic Zones: Political priority, economic gamble.” *The Economist*. April 4, 2015.

FDI. Seeing as though total FDI inflows into Ghana grew substantially over that period, it can be concluded that SEZs played an important part. Other successful examples include Kenya and Tanzania, where SEZ FDI represented 20 and 18%, respectively, of total national FDI.<sup>17</sup>

Overall, there is an increasing interest from national and international actors to develop and invest in African zones. For instance, the Chinese government has announced plans to invest in SEZs in Burundi, Ethiopia, Senegal and Malawi, amongst others.<sup>18</sup> Furthermore, zone programmes in Madagascar attracted FDI from China, France, India, and Mauritius, focused on apparel and textiles, and mainly served the EU market,<sup>19</sup> while Germany, France and Denmark have invested in Mali's industrial zones.<sup>20</sup> The Togolese zone programme has attracted investment from twelve different countries. Therefore, SEZs are a phenomenon that is becoming increasingly popular in African states in fragile situations to attract FDI, overcoming substantial barriers to investment, including insufficient infrastructure.<sup>21</sup>

## 2 Establishing growth poles

A recent trend can be observed towards using SEZs as so-called 'growth poles' in Africa. Since around the late 2000s, there has been an overwhelming international trend away from traditional enclave-based and purely export-focused EPZ models towards a new model of SEZs driven by more support from multilateral development institutions and Chinese interest in Africa. The alternative approach seeks to use zones as 'growth poles', i.e. integrated regional growth initiatives based on domestic industry clusters and local labour markets and around key trade infrastructure (ports, roads, power projects).

In parallel, so-called 'turnkey' SEZ projects are making their appearance on a continent increasingly attractive to emerging economies. China, in particular, has been driving the idea of such SEZs in Africa by launching zone programmes – entirely funded, developed and operated by China – specialising on specific regional activities or sectors and thus becoming poles of Chinese investment in those African regions. The goal is for these SEZs to lead to the development of sector-based clusters around each of them.<sup>22</sup> The investment commitments made were significant and – amongst other

<sup>17</sup> Farole, T. 2011. "Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience." World Bank.

<sup>18</sup> AfDB. "Environnement de l'investissement Privé au Burundi." ; Tadesse, F. 2014. "China Agrees to Construct Flagship Special Economic Zones." Addis Fortune. 11 May 2014. ; TradeMark South Africa. 2012. "China to fund Malawi industrial zone project."

<sup>19</sup> Foreign Investment Advisory Service (FIAS). 2008. "Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development." World Bank.

<sup>20</sup> Boyenge, J.P.S. 2007. "ILO Database on Export Processing Zones, Revised." International Labour Organisation.

<sup>21</sup> Consulat du Togo au Brésil. 2014. "CEDEAO – Togo: Le Port Autonome de Lomé et sa zone franche." [http://www.consuladotogo.org.br/pagina\\_html\\_franc%C3%AAs/cedao\\_togo.html](http://www.consuladotogo.org.br/pagina_html_franc%C3%AAs/cedao_togo.html)

<sup>22</sup> Brautigam, D. and Xiaoyang, T. 2011. "African Shenzhen: China's Special Economic Zones in Africa." *Journal of Modern African Studies*.

things – included a commitment to invest USD 500-750 million in a zone in Mauritius<sup>23</sup> and hundreds of millions of USD in a Zambian zone.<sup>24</sup> Additionally, the government of the United Arab Emirates is developing an integrated growth pole SEZ in Senegal. India and Turkey have also been involved in the development of growth pole zones in various African countries.<sup>25</sup>

The new trend towards growth poles can present an opportunity for fragile situations in particular. In addition to potentially attracting significant FDI to complex markets through an improved investment climate, this new SEZ model emphasises an integration with the national economy, private sector participation, the resolution of land constraints, and regional integration. These factors also address underlying economic drivers of fragility as identified under the AfDB strategy such as economic inclusion, unemployment, and regional instability, while contributing to building resilience.

There are concrete signs that SEZ programmes in African countries affected by fragile situations may well implement these lessons: In Côte d'Ivoire, the government is currently planning three SEZs around sectoral clusters and regional growth poles, including – amongst others – the textile industry in Bouake, a city that was at the epicentre of the political crisis in the country. In the Democratic Republic of Congo, a first SEZ pilot area – focusing on agro-industries – has been established close to the international airport and at the intersection of the Congo River (port access is provided) and the main road towards the interior of the country.<sup>26</sup> In 2012, the Mauritanian government officially launched an initiative for the development of the Nouadhibou zone as a comprehensive economic pole.<sup>27</sup> Thus, governments of African countries affected by fragile situations have increasingly set their eyes on the growth pole model of SEZs.

### 3 Encouraging private sector participation

Additionally, the growth pole SEZ model foresees an important role for the private sector in zone management and operation. As Farole (2011) shows, one of the key success factors for SEZs in Africa is for policymakers to work closely with the private sector to develop zone policy according to changing needs. Given the large investments required to support zones and their uncertain return in fragile situations, private sector participation is important to reduce risk in zone programmes. For instance, in Nigeria, many recent projects in the flagship zone in Calabar are Public-Private Partnerships (PPPs) between private developers and government, while the country's Oil and Gas

<sup>23</sup> "Zone Économique de Riche-Terre Jin Fei Retient l'Attention." L'Express. 21 October 2009.

<sup>24</sup> Karmody, P. 2009. "An Asian-driven Economic Recovery in Africa? The Zambian Case." World Development.

<sup>25</sup> Farole, 2011.

<sup>26</sup> RDC Agence Nationale de la Promotion des Investissements (ANAPI). 2012. "Official communiqué inviting investors to join the Special Economic Zone of Maluku/Kinshasa."

<sup>27</sup> Présidence de la République. République Islamique de Mauritanie. Nouadhibou Free Zone. 2014. "Investing in the free zone." <http://www.ndbfreezone.mr/eng/index.php/en/the-free-zone/47-investing-in-the-free-zone.html>

Free Zones are privately operated but publicly owned.<sup>28</sup> In Gabon, global agro-commodity player Olam entered into a joint venture in 2010 with the government to establish an SEZ with the broader objective of diversifying the Gabonese economy, creating jobs in remote rural areas, and attracting other investors to develop the industrial sector.<sup>29</sup>

Such private sector participation can result in a broader engagement of the private sector in the economic, social and political development of the country beyond the zone itself. If collaboration is successful, the private sector can become a long-term partner in constructive policy-making. This echoes calls for increased responsibility for companies in addressing fragility. However, there is a risk in fragile situations that frequent changes at the government level may counter a productive long-term relationship between the state and key investors.

#### 4 Supporting SMEs

SEZs tend to principally attract foreign investment and more mature local firms. However, they also have a potential to support local SMEs. One way to do so is by encouraging SMEs to enter the zone directly by lowering entry costs. Another way is to facilitate local SMEs becoming suppliers to larger zone occupiers by streamlining procurement processes. Hereby, SMEs can become catalysts for a broader entrepreneurial culture and advocates for doing business in the host country. Examples for constructive interventions in this area are the establishment of incubators, encouraging larger firms to provide training, mentoring and other support services, appointing an SEZ liaison on supply chain and SME support issues, and organizing regular formal and informal dialogue between zone developers, operators and relevant national business development organisations. Such strategies have been successfully implemented in Kenya, where the Export Processing Zones Authority (EPZA) established an incubator programme to help local SMEs grow into exporting enterprises and create direct exporting and subcontracting relationships with larger firms. In Ghana, a multi-purpose industrial park offered local firms an opportunity to become better integrated into the supply networks of exporters in an SEZ.

#### 5 Focusing on competitive subsectors or projects

Fragile states are often perceived as having a low manufacturing and production base, which would indicate that there is limited resistance to liberalizing the entire country's business environment. Seeing as though SEZs aim to circumvent this resistance, it raises the question if SEZs indeed have the potential to be reform pilots in such contexts. However, the two are not mutually exclusive. While nationwide investment climate

<sup>28</sup> Farole, T. 2011.

<sup>29</sup> Government of Gabon, Olam International. "Gabon Special Economic Zone."

reform is an important tool to attracting FDI, the attractiveness of the SEZ model is that it aims to take advantage of particular investment opportunities in competitive subsectors. Recent studies on guiding principles in promoting investment in fragile and conflict-affected situations recommends a focus on competitive subsectors or projects and on investors most likely to invest in fragile contexts.<sup>30</sup> Successful SEZ programmes in the past have done exactly this: After rigorous analysis of the sectors of comparative advantage, successful SEZs targeted specific sectors and investors with a potential to become a catalyst for wider private sector development.<sup>31</sup> Lesotho's zone programme, for instance, focuses on clothing and textile products and investors from China, who in return can export their products to the US under AGOA. This also allows for addressing sector-specific economic, political and social sensitivities – another important success factor in engagements in fragile governance environments.<sup>32</sup>

## 6 Economic diversification

As outlined earlier, competition over and access to natural resources, poor natural resource management and economic exclusion can present significant drivers of fragility. A 2015 Chatham House report confirms that resource investment in fragile and conflict-affected states is unlikely to be 'conflict-neutral'.<sup>33</sup> Overcoming this so-called 'resource curse' is a key step towards more political and economic stability in fragile contexts. Many of today's rapidly growing economies, outside of Africa, were previously dependent on a limited set of sectors – usually in natural resources, agriculture and a limited set of industrial activities. Diversification has been a secular economic policy objective of all developing countries, one seen as essential to the sustainability of growth. Collier (2014) also sees diversification as an important way in which the private sector can mitigate fragility.

SEZs can play an important role in this process. SEZs – and particular those that are mixed-use – can provide an avenue for a gradual emergence of a large manufacturing sector focused on export-oriented industries (rather than being focused on simply exporting natural resources) and services sectors. These sectors have been often proven to create meaningful employment. Zone programmes, mostly in their EPZ iteration, have in the past sixty years or so played an important role in this. Several past zone programmes have successfully led to the formation of a large manufacturing sector focused on export-oriented industries.

From a theoretical standpoint, Auty and Pontara (2008) possibly represent the first coherent conceptualization of SEZs as an instrument directly relevant to the resource

<sup>30</sup> Whyte, R. and Griffin, C. 2014. "Promoting Foreign Investment in Fragile and Conflict-Affected Situations." World Bank.

<sup>31</sup> Farole, T. 2011.

<sup>32</sup> OPIC. 2014. "Seven Approaches to Developing Projects in Fragile Governance Environments."

<sup>33</sup> Bailey, R., Ford, J., Brown, O. and Bradley, S. 2015. "Investing in Stability: Can Extractive-Sector Development Help Build Peace?" Chatham House.

curse. They argued that one of the most significant obstacles to growth, economic diversification and poverty reduction was political economic resistance to reform – notably from the rent-seeking groups that control a large part of the economy, and stand to lose from increased economic openness. As a potential solution, progressive reforms should be introduced, but in a manner and at a pace suitable for gradual adjustment by rent-seeking groups. SEZs can be used as pilots for economic policies different from those governing the rest of a country's territory.

For instance, Mauritius deployed an EPZ in 1971 at a time of great dependency on sugar and its associated rent. The zone focused on the provision of world-class infrastructure and unsubsidized incentives to act as a magnet for non-traditional transformation activities focused on the export and domestic markets, and acted as a catalyst for reform. Through higher taxation of sugar profits and a restriction of capital exports, the EPZ decreased the country's dependency on a highly variable sugar rent – affected by unpredictable weather conditions and volatile prices. The privately owned and highly entrepreneurial sugar industry embraced the opportunity to use its 'super-profits' to generate additional income in industries like clothing, jewellery and others. This early reform zone would in effect have attributes similar to those of SEZs.

The explicit link between SEZs and resource-induced economic management is more recent, with a growing number of countries adopting SEZs with the intent of achieving diversification. Amongst them are Botswana, the Democratic Republic of the Congo, Gabon, Mauritania, and South Africa. In Lesotho, exports from SEZs represented 64% of national manufacturing exports in 2008.

In sum, SEZ programmes have the potential to prevent a resource curse. This may be particularly important for fragile situations in Africa, including the Mano River Union or Great Lakes Region, where recent impressive economic growth is overwhelmingly driven by natural resources. Thus, SEZs become an interesting part of the toolkit to mitigate drivers of fragility in these regions.<sup>34</sup>

## 7 Attracting more multilateral support

This trend towards new model SEZs is also changing the international policy landscape. International development finance institutions (DFIs), traditionally not in favour of special trade regimes, are now more readily providing support for the creation of such SEZs. There are a number of current projects across Sub-Saharan Africa that are either supported or facilitated by DFIs.

This support by multilateral development institutions represents somewhat of a change of paradigm for these organisations. Previously, multilateral development institutions were somewhat sceptical of SEZs – EPZs in particular – in terms of their impact on

<sup>34</sup> Farole, T. 2011.

overall reforms. They thus tended to discourage the use of EPZs where they could, and where they could not, they tended to keep them small and limited in scope. The focus was on countrywide reforms. Today, these organisations seem to have recognised that these countrywide reforms, notably the World Bank's structural adjustment programmes in Sub-Saharan Africa, have borne very limited returns, and that the SEZ approach of growth poles and reform may be more effective. However, certain development partners may have underlying agendas, for example by introducing certain types of reforms that may de-regulate the economy to a larger extent than the government may initially have wanted. In several SEZ policy design processes in Africa, different development partners displayed fundamental differences on their views of the economic and institutional roles of SEZs.

In principal, however, governments in African countries affected by fragile situations can attract important multilateral support for their SEZ strategies, in addition to the existing interests from bilateral partners and private investors.

## 8 Fostering institutional collaboration and policy coherence

As further explained earlier, SEZ programmes require extensive regulatory and institutional coordination. One of the key lessons from the first generation EPZs is that multiple pieces of legislation, particularly if administered by different institutions, result in weak programme coordination. Addressing all the key constraints faced in the implementation of the EPZ programme, particularly with regard to the overlaps and gaps in the regulatory and institutional framework, will therefore be a critical success factor for a SEZ programme in a fragile situation. Fostering such institutional coordination would also contribute to more clear mandates for different institutions in terms of zone planning, management, and policy implementation. Ultimately, this strengthens different institutions' capacity and skills in the specific task it is assigned – both in the particular zone, but also in terms of broader national objectives.

Additionally, the efficient and sustainable management of the zone requires a significant collaboration between different institutions and non-state actors. Such collaboration helps foster policy coherence, policy stability, and, ultimately, state capacity.

As seen before, given the characteristic capacity challenges of governments in these contexts, it would be necessary to have significant private sector input in the development and management of any zone programme in a fragile situation. Securing this output requires the government to reach out to influential corporate actors and associations, build partnerships with these players, and establish a private-public dialogue (PPD). Indeed, as also shown earlier, many successful zones have been public-private partnerships. Such partnerships also foster the exchange of information and thus strengthen public sector capacity. A recent report on PPD claims that PPD is highly necessary in fragile and conflict-affected situations to fill the gap resulting from

the lack of legitimate institutions. It helps create transparency and trust among stakeholders, and identify the need for reforms and interventions that can improve the business environment and attract investment.<sup>35</sup>

Indeed, effectively addressing fragility and building resilience requires the collaboration of all stakeholders: governments, the private sector, civil society, and development partners. Ideally, the design and implementation of a SEZ policy ensures such multi-sectoral collaboration beyond the management of that specific zone.

## Conclusion

The benefits of a SEZ, following the growth pole model for a fragile situation are thus two-fold:

- Firstly, SEZs can have positive static impacts in terms of attracting FDI and creating employment.
- Secondly, growth pole SEZs have the potential to address more structural drivers of fragility in Africa like the overreliance on natural resources, economic and social exclusion, infrastructure deficits, and weak governance.

## 4 The practice: Evidence from SEZs in fragile situations in Africa so far

While the theory thus shows that SEZs have the potential to be a useful tool to spur economic growth in fragile situations, in practice, SEZ programmes exhibit a number of challenges in these environments.

### 4.1 The failure of first generation EPZs in Africa

Liberia in 1970, Mauritius in 1971 and Senegal in 1974 were the first African countries that embarked on EPZ programmes – enclaves purely focused on exports – in an attempt to replicate the success of the Asian countries of the 1960s and 1970s. However, most African countries did not implement free zone programmes until the 1990s and 2000s and over 80% of these programmes started within the past two decades. According to the most comprehensive account of SEZs in Africa, these EPZ programmes have largely failed in view of small static (employment, investment, export figures) and dynamic (structural economic change) impacts. At the last measurement in 2008, 114 zones existed in Africa.

<sup>35</sup> World Bank Group, 2014. “Public Private Dialogue in Fragile and Conflict-Affected Situations.”

## Performance

At the time of the last comprehensive measurement of zone programmes around the world in 2008, 114 zones existed in Africa, making up only 5% of all global zones.<sup>36</sup> What is more, African zones exhibited low levels of investment, exports and job creation and were surprisingly capital-intensive. Non-African zones generally outperformed African zones in terms of FDI and FDI per capita, while African zones supported no more than 35 firms on average (in comparison Vietnam's programme supported up to 3,500 firms). Additionally, nominal exports from the African zone programs were extremely small (on average 10-15 times smaller than the corresponding absolute and per capita exports in the non-African programs).<sup>37</sup> Zone programmes in South Africa, Mauritius, Lesotho, Kenya, Nigeria and Madagascar have been the only countries found to generate significant employment.<sup>38</sup>

In addition, almost all the programmes in Africa have not played any significant role in catalysing wider reforms, while comprehensive forward and backward linkages between firms inside and those outside the zone are practically non-existent.<sup>39</sup> Even the improved business environment inside the African zones falls below international standards. For instance, despite the 50% reduction in electricity-related downtime in the African zones, reported average downtime only reaches the average levels outside SEZs in the non-African countries. A similar pattern is observed in customs clearance. Most zones are still failing to deliver quality employment and a living wage, while gender-specific concerns are ignored despite the high concentration of female workers in many zones. Moreover, in many countries, land acquisition, compensation, and resettlement practices are inadequate.<sup>40</sup>

Thus, in terms of FDI, numbers of firms, exports and other static economic indicators, as well as business environment and dynamic factors, African zones have – until recently at least – underperformed.

## Reasons for failure

There are a number of key reasons as to why the first generation zone programmes in the 1990s and early 2000s have failed to achieve meaningful static and dynamic growth. Tough competition from Asian manufacturing exposed African zones' competitive weaknesses in terms of high labour costs and inability to reach scale. Poor regional trade integration also made it difficult for these zones to take advantage of potential regional value chains due to tariff and non-tariff barriers.

<sup>36</sup> FIAS. 2008.

<sup>37</sup> Farole. 2011.

<sup>38</sup> Stein H. 2008. "Africa, Industrial Policy and Export Processing Zones: Lessons from Asia." Paper prepared for Africa Task Force Meeting, Addis Ababa, Ethiopia.

<sup>39</sup> Stein, 2008.

<sup>40</sup> Farole, 2011.

In addition to these exogenous factors, a number of African governments have made bad implementation choices. Firstly, almost none of the African zones have taken the approach to use their SEZs as reform pilots – as has been done in the programmes that are held up as success stories (primarily China, but also Mauritius).<sup>41</sup> Secondly, governments have preferred the EPZ-based enclave model, which meant that zones were disconnected from wider economic strategies.<sup>42</sup> Lastly, the government-run zones have had insufficient policy support in terms of supporting domestic investment and promoting linkages, training, and upgrading skills and technology. In sum, many programmes have suffered from the failure to establish a policy environment that offers investor confidence in transparency and predictability.<sup>43</sup>

Because of these factors, African SEZs have tended to compensate for their overall lack of competitiveness through increased incentives and subsidies – often in the form of perennial tax holidays, highly subsidised real estate and utilities, and in the worst cases, direct subsidies to investors, all of which provided to avoid the disruptive effect of threatened job losses. This has led to a ‘race to the bottom’ and SEZs being misused as tax havens for companies that would have invested in these countries regardless of zone programmes.

Further analysis suggests that programmes suffered from lack of effective strategic planning, management,<sup>44</sup> and proper monitoring and evaluation mechanisms.<sup>45</sup> In many of the African SEZs, the agency responsible for developing, promoting, and regulating the programme lacks resources, capacity, and institutional agency to carry out the mandate.<sup>46</sup> Problems of national policy instability further inhibit institutional coordination.

In sum, the evidence from zone programmes in the whole of Africa – not only in fragile situations – suggests that problems of weak governance and instability have played an important part in such programmes’ ineffectiveness to date. Seeing as though issues of institutional capacity and volatility would most likely be exacerbated in fragile situations, implementing an SEZ programme should be all the more challenging in those contexts. Observations from the initial stages of policy design and formulation in Zimbabwe’s SEZ programme appear to confirm this hypothesis.

## 4.2 The case of Zimbabwe’s SEZ programme

Zimbabwe can be considered to be a state with severe fragility issues. The country has been facing significant political and economic challenges for the best part of the last two decades. Between 2000 and 2009, the economy registered a decline of as much

<sup>41</sup> Ibid.

<sup>42</sup> Farole, T. 2010. “Special economic zones: introduction and recent research.” Presentation at flagship workshop on Special Economic Zones in Dar Es Salaam, Tanzania. World Bank. Bank-Netherlands Partnership Program.

<sup>43</sup> Farole, 2011.

<sup>44</sup> Watson, P.L. 2001. “Export Processing Zones: Has Africa Missed the Boat? Not Yet!” Africa Region Working Paper Series No. 17. World Bank, Washington DC.

<sup>45</sup> Zeng, D.Z. 2012. “SEZs in Africa: Putting the Cart in front of Horse?” Let’s Talk Development: A Blog Hosted by the World Bank’s Chief Economist.

<sup>46</sup> Farole, 2011.

as 40% as it struggled with hyperinflation. Confronted with revenue problems and high indebtedness, the government set out in 2013 to consolidate reforms, when SEZs were identified as one of the key development policy tool to achieve economic growth and inclusion through employment generation. This represented a second attempt of a zone programme in Zimbabwe, after an export-oriented zone programme had largely failed between 1996 and 2006 for reasons similar to the ones summarised above.

The following analysis is based on the lessons learned while providing Technical Assistance (TA) by the AfDB to the government of Zimbabwe in the initial stages of a second generation SEZ policy formulation and planning. The observations fed directly into this research and are divided in exogenous factors – largely beyond the control of government – and endogenous factors – where government, its partners and the private sector have a role.

### Implications of exogenous factors

The implementation of Zimbabwe's SEZ programme is significantly constrained by the small size of the domestic market. Its formal sector has retreated considerably while the informal economy has somewhat compensated that decline. However, the informal economy presents fewer opportunities for linkages with businesses in an SEZ because of the lack of structure and under-developed nature of the businesses in this sector. The resulting necessity to concentrate on the export market is rendered difficult by the country's low level of competitiveness, the fact that Zimbabwe is landlocked, the erosion of the country's factors of production and its poor investment climate. This makes the prospects of large investments in SEZs for exports in Zimbabwe unlikely at present. In return, this means that the country's SEZ programme would need to perform exceptionally well in order to compensate for these vulnerabilities. This is not an impossible task, but represents a difficult challenge considering the country's current economic and political situation.

### Implications of endogenous factors – the evidence so far

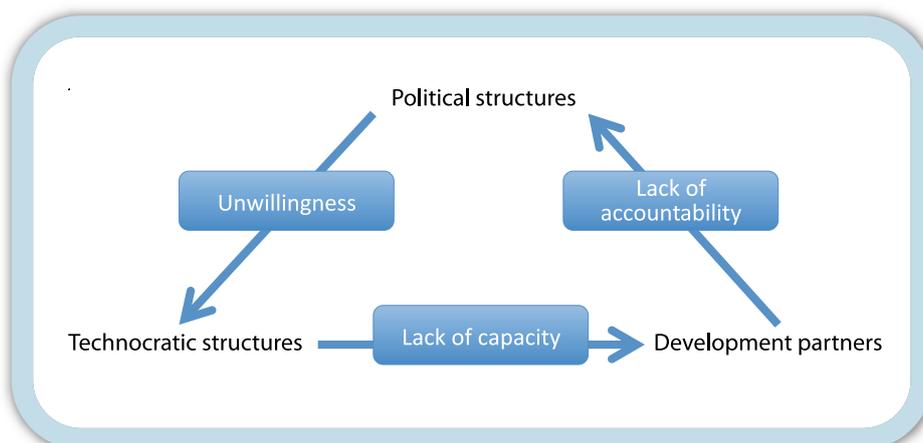
These exogenous factors notwithstanding, good design and implementation – by government, development partners and the private sector – can compensate for vulnerabilities. It is important to note that experience shows that the early stage of SEZ development is primordial in the success or failure of a SEZ programme. There are a number of challenges that have negatively impacted on the rollout of an effective SEZ programme.

- Lack of policy clarity
- Politicized decision-making
- Lack of ownership due to insufficient technical and financial capacity

The perceived solution to this veritable 'stalemate' is a request for external assistance. At this point, responsibility is often deferred to development partners (e.g. foreign

consultants, international organisations, etc.) to provide the required technical and financial support in addition to making the difficult political decisions. In the Democratic Republic of Congo (DRC) for instance, the SEZ programme encountered similar challenges as the ones observed in Zimbabwe, upon which development partners assumed responsibility of the programme and implemented an SEZ policy on the basis of large additional funding and technical expertise. However, these external players often lack the accountability needed for the legitimate political action required to ensure the long-term sustainability of a zone programme due to their absence from the domestic political process. The result is a situation in which responsibility is passed around in a triangle between political structures, technocratic structures, and development partners, where no actor assumes full ownership over the policy (see Figure 1): The political structures are unwilling, the technocratic structures lack the capacity, and development partners cannot provide the required accountability.

Figure 1 Lack of ownership



Source: Authors

### 4.3 The lessons learnt from SEZs in fragile situations

In sum, several of the drivers behind the problems encountered during the initial phases of policy formulation and implementation are illustrative of governments in fragile situations. It seems that governments experiencing policy crises are particularly interested and prone to pursue SEZ policies, which they see as a panacea to political and economic problems. This also explains recent observations by The Economist that SEZs “are all the rage among governments hoping to pep up their trade and investment numbers.”<sup>47</sup>

However, policymakers underestimate the institutional coordination and ownership that a successful SEZ policy formulation and implementation requires. When the choice of SEZs is made based on imminent political-economic pressures, the process is

<sup>47</sup> “Special economic zones: Political priority, economic gamble.” The Economist. April 4, 2015.

flawed from inception, as governance deficits subsequently exacerbate the problems that come with an inadequate preparation. This may lead to programme failure or the creation of flawed SEZs that either never really take off or require constant subsidisation – both at great cost to government and the economy.

### SEZs require some state capacity

SEZs can help states avoid the need to introduce economic reforms on a national scale, but they do require some state capacity and will not succeed without it. The state needs to be able to coordinate across departments/ministries (where they may have previously operated as silos), it needs to be able to follow a thorough SEZ policy and implementation process (getting sign off from a broad range of actors, taking on good advice, and making the policy and legislation effective and strong enough) and the state needs to be able to work well with the private sector in order for the SEZ to become successful. Establishing SEZs therefore requires more than a superficial commitment made in the throes of crisis. They require strong political backing when painful choices become patent. And, in fragile economic situations, political support is not sufficient without policy clarity.

### SEZ policy design and implementation is a lengthy, difficult and costly process

SEZ programmes take years to develop through well-understood processes of formulation and implementation<sup>48</sup>. It rarely takes less than three years for a SEZ to open after the policy has been declared – assuming efficient programme management in an environment with the right economics and adequate capacity and funding. Once on-stream, SEZs take years to fill up sufficiently to generate meaningful economic benefits. The first few years of a SEZ programme are essentially a hard going process of planning, engagement and negotiation, legislative action, investment promotion and costly investment in infrastructure. Policymakers are usually not fully aware of these facts when they choose SEZs as a ‘quick fix’.

SEZs therefore constitute a complex policy tool requiring the presence of solid technocratic capacity in design and implementation. Senior civil servants must be able to lead policy formulation, generate an implementation process, and make this process happen. Deficits with regards to political processes, policy certainty and technocratic capacity aggravate a lack of intra-governmental consensus and an unwillingness to take ownership of the SEZ policy formulation and implementation process. Whilst development partner assistance can partially compensate for lacks in this, it cannot replace it. When development partners take the lead the risks of failure, rejection or creation of an artificially imposed policy tool are high.

<sup>48</sup> See for instance the IFC SEZ Practitioner’s Toolkit, which provides a comprehensive guideline on the mid- and downstream design and implementation processes.

### **There is an increased threat that SEZs in fragile situations may fall captive to vested interests**

Additionally, objective fact-based analysis of the opportunity presented by SEZs is essential. This analysis, which should be done as the first part of the implementation plan, may well be resisted by both the bureaucracy (civil servants/technocrats) and senior political actors. This is a key area where development partners should focus their attention, leveraging their financial and technical assistance. Failing this, the policy is unlikely to deliver broad socioeconomic benefits, and may very well fall captive to vested economic interests who see SEZs as a convenient tool toward economically harmful tax breaks and other advantages.

### **Meaningful private sector participation is even more important in fragile situations**

Finally, SEZs are by their nature a private sector serving policy tool. Their role should be to provide the environment where there is expansion of the private sector at a faster pace and along directions that are different from what would otherwise occur. Notwithstanding what has been written about vested interests and the need to protect the SEZ programme from these, it is essential to procure, early on, broad and meaningful private sector participation in the design and implementation of the policy. This means more than mere formal consultation after the key decisions have already been made. Inclusion is all the more important in a context of low capacity.

### **Lessons to take forward**

While SEZs may present a potential solution for addressing some of the key constraints to FDI and private sector operation in countries experiencing fragile situations, it remains that experience shows the difficulties of designing and implementing SEZ programmes in such situation. Besides the obvious issues presented by the financial and economic implications of SEZ development, a key difficulty is the requirement for sufficient state capacity in formulating and implementing a coherent, responsive and reasonable SEZ package, without either failing to do so or being captured by vested interests.

Indeed, although SEZs are seen as a solution, they require concentrated political will, support from business and cooperation from the bureaucracy – exogenous factors not included (and these play a critical role, which require all endogenous factors to work better if the former are absent). These conditions are often absent or not strongly prevalent in fragile situations.

Therein lies the paradox of SEZs in states affected by fragile situations: while they represent a potential solution because of their concentrated nature (assets and location), this very concentration requires the gathering of meaningful amounts of capacity in

design and implementation. In some cases, SEZs, rather than solving the problem simply highlight and potentially heighten the problems of fragility.

Yet, there are reasons to be more optimistic about the SEZs currently being developed in Africa. As explained earlier, the second generation SEZs are focusing on the establishment of growth poles, which differentiates these zones from the unsuccessful enclave-based EPZs. There is also hope that SEZ developers and operators are implementing the lessons learned with regards to incentive packages and a better integration with the national economy.

It derives that not all situations of fragility would present themselves for the development of SEZs. Some critical minimal conditions need to exist, mainly: i) presence of real economic opportunity and assets that are hobbled by investment climate issues that can be meaningfully resolved by SEZs; ii) presence of political will to deliver the necessary competitiveness package; iii) presence of sufficient state capacity to support the design, development and operation of SEZs.

Where those conditions exist, there is a significant and continued need for support from development partners. The challenge for development partners is to identify and support individuals and/or divisions in government, where those conditions are prevalent and who have the political influence to drive a SEZ strategy and implementation plan. This requires influence over political leaders and senior civil servants, a good knowledge of government workings, as well as the ability to involve business representatives. It is quite possible that even in countries in fragile situations, these individuals and/or government divisions can be identified.

## 5 Recommendations

The topic of SEZs in fragile situations is very complex. SEZs are tools that are developed in response to very specific economic situations characterised by unique competitive factors such as resource endowment, demand, labour, regional integration, geographic location, and the competitiveness of a country's broader business environment. Fragile situations, on the other hand, differ greatly from another. Lastly, empirical knowledge on SEZs in Africa, let alone on SEZs in fragile situations in Africa, is lacking. Thus, it is difficult to advise task managers, governments and investors on what is right or wrong, as every fragile context will require in-depth analysis and studies.

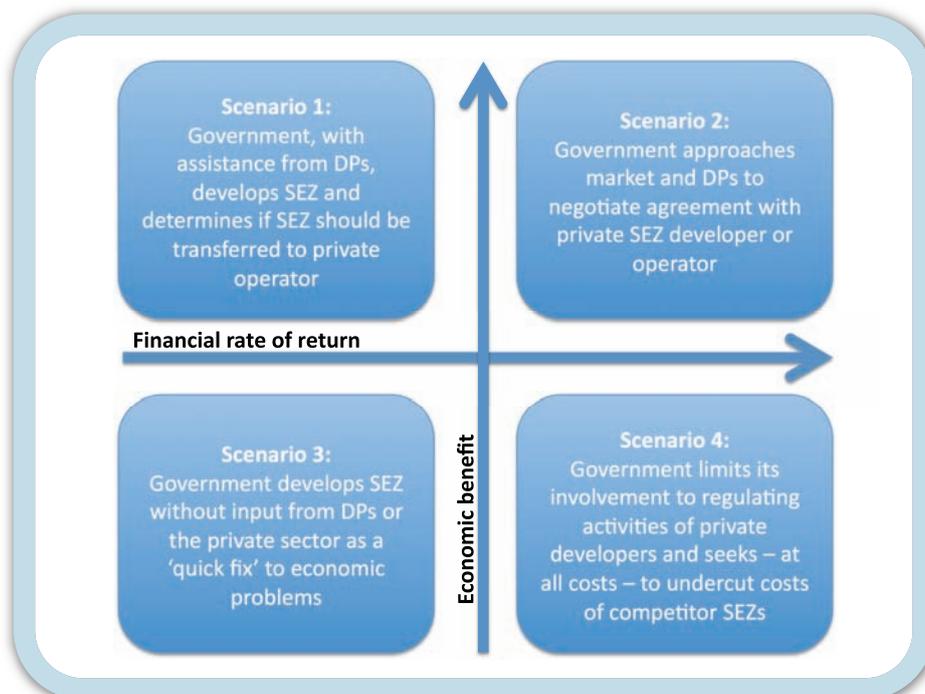
Nonetheless, based on the above analysis of global experiences of SEZs and their relevance to fragile situations in Africa, several recommendations can be derived for development partners, governments and the private sector. The graph below provides a simple, but highly important overview of the impact of economic and financial returns (see Figure 2)<sup>49</sup>: The higher the economic returns, the lower the risk for government; the higher the financial returns, the lower the risk for the private sector.

When the anticipated economic returns are high, development partners should support the programme because economic benefits to the country justify such an intervention. The proviso is that costs (such as development, operation, regulation and incentives will not surpass these economic benefits).

The figure shows that high economic benefits can be derived from an SEZ in a fragile situation only if development partners (DPs) and the private sector are included in the design and implementation of an SEZ programme. If the private sector is involved as zone operator or merely contributes to the design of the programme determines the financial rate of return, but not necessarily the economic benefits. The figure further shows the risks of SEZs in fragile situations, which are two-fold: Firstly, an SEZ developed alone by a government with insufficient capacity (scenario 3) may fall prey to vested public sector interests and risk not benefiting any of the involved stakeholders. Secondly, governments plagued by fragility might give in too easily to private sector demands, which might lead to a 'race to the bottom', whereas only investor interests are considered, while wider economic benefits are rare.

Based on the theoretical and practical conclusions provided earlier on the role and potential of SEZs in fragile situations and the observations in Figure 3, a number of broad recommendations can be derived for key stakeholders.

**Figure 2** Potential economic and financial returns from an SEZ in a fragile situation



Source: Authors

<sup>49</sup> The graph is derived and adapted from an IFC study.

## 5.1 How governments can derive benefits from SEZs

This paper has established that fragile situations present distinct problems in the implementation of SEZ programmes, notably a potential lack of sufficient government capacity and choosing to embark on an SEZ programme for the wrong reasons. A few key recommendations can be derived from these conclusions:

- 1 **Choose the right SEZ for the right context:** In a context of competitive SEZs across the continent and in Asia, the zone programme must be based on a rigorous analysis of the sources of comparative advantage, the vulnerabilities around it and the identification of the most promising sectoral opportunities. It is helpful to remember that fragile states are not only about natural resources, but may have other context-specific comparative advantages. This also underlines the potential of SEZs as a tool for focusing on competitive subsectors (see point 5 in section 3.2).
- 2 **Avoid a ‘race to the bottom’ by using best practice incentives:** There is a risk that SEZs become tax havens as countries experiencing fragile situations seek to undercut more mature economies with regards to tax incentives and production costs. However, in order for a government and country experiencing a fragile situation to derive benefits from an SEZ programme, best practice must be applied when establishing the zone’s legal framework. According to legal zone experts Locus Economica, investment and fiscal incentives should be competitive, but not excessive and tied to outcomes. This best practice typically includes, but is not limited to, i) low reliance on tax holidays and other fiscal incentives, ii) simplicity (maximum three to four taxes), iii) avoidance of duplication of national tax administration, and iv) elimination of indirect taxes.
- 3 **Comprehensively involve the private sector:** One important way to compensate for the institutional weaknesses often prevalent in governments of states experiencing fragile situations (see 4.2) is to include the private sector in the SEZ design and implementation process. In fragile situations, private sector involvement should be comprehensive, and could include strategy, development, financing, operation and administration of key aspects of the regulatory regime.

In addition, design and implementation by government can compensate for vulnerabilities. The following success factors Farole (2011) has identified remain particularly valid for governments facing fragile situations:

- There must be clear and sustained political support for a programme based on the right design attributes and correct implementation.
- The programme must be an integral part of the national development strategy, rather than an alternative to it or an afterthought.
- Sustained administrative support is required, from inception and design to implementation. It is essential that the relevant administrations (tax, customs,

immigration, labour, commerce, energy, ports and airports, etc.) be engaged and provided with the resources needed to support operation.

- Design of a coherent set of investment support measures, which must be directly derived from the competitiveness of the country, and its weaknesses. The lower this is the more important these measures become.
- The infrastructure offering is an essential component of success. This must be vastly superior to what exists outside, and must be on par with international standards. Infrastructure includes internal as well as near-external infrastructure: serviced land, utilities, and connectivity. It must be priced competitively.

In sum, there needs to be a broad understanding of why SEZs have been chosen and for what purpose. The role and objectives need to be defined by the executive with sufficient precision. This is even more important in fragile situations, where any lack of clarity on these questions risks to be further exacerbated by an underlying governance deficit as the implementation process proceeds. This goes back to the observation that SEZs are 'dangerously attractive', particularly in fragile situations (see 4.3). SEZs must offer a compelling investment and operating climate.

## 5.2 How the private sector can increase benefits from investments in SEZs

By definition, SEZs seek to attract investors. Provided that an investor has made the decision to invest in an SEZ in an African country experiencing fragility, the following recommendations serve to mitigate business risks and, ultimately, increase financial returns:

- 1 **Take an active participatory role in the design and management of the zone:** In fragile contexts, governments and public SEZ implementation agencies will require assistance and input from the private sector in the design and management of the zone, particularly when it comes to decisions on incentives and tax regimes. As shown before, active private sector participation in zone management has been a success factor in SEZs in Africa in the past (see 3.2.3) and thus presents an opportunity for SEZs in fragile situations: Investors benefit from such participation, as incentives can be more targeted to their needs.
- 2 **Build local supply networks:** Given the specific nature of many of the sectoral uses and functions proposed for SEZs, it may be more attractive for large occupiers to purchase their input goods, supplies and feedstock locally or from the host country. Potential local and national supply inputs and services can include technical equipment, food and beverages, on-site security, consumables, or legal services. Links with local and national suppliers can create broader benefits to the zone and contribute to a better relationship between the zone occupiers and host government (see 3.2.4).

- 3 **Take a long-term view:** Earlier sections have demonstrated how fragile contexts can be characterized by frequent policy shifts and leadership changes. Furthermore, experience shows that SEZ policy design and implementation can be a long and difficult process, especially for governments with less capacity than in more stable contexts (see 4.3). Thus, financial benefits from entering into an SEZ should not always be expected immediately. However, once a zone is well established, benefits will start to rise.

### 5.3 How development partners can support SEZs in fragile situations in Africa

#### Corporate level: Ensuring that SEZs live up to their potential in fragile situations

As Africa's premier development finance institution and building on its comparative advantage as a 'trusted advisor and honest broker', the role of the AfDB in advising and supporting governments in fragile situations as to whether or not and how to establish SEZs is meeting a critical gap in the development financing architecture for the post-2015 era.

Against this background, it is argued that it is timely for the Bank (and other development partners) to assume leadership in this particular area, especially given the fact that development partners were previously not supportive of the idea of SEZs (see section 3.2.7). Thus, this report makes the following specific recommendations to be considered by the Bank's management based on the findings of this study:

- 1 **Consider the idea of developing SEZs in fragile situations as one part of the toolkit to address fragility and build resilience:** Overcoming the challenges of establishing SEZs in fragile situations is not impossible for development partners, as they can be solved through a more thorough and holistic policy design process. On the other hand, the outlined potential of SEZs in fragile situations is significant. Successfully implementing an SEZ programme in a fragile context can catalyse wider positive economic, social and political impacts beyond the zone itself through diversification and economic linkages (see section 3.2.9). The AfDB is particularly well placed to support and, if necessary, lead a multi-stakeholder dialogue around overcoming these challenges. Country Strategy Papers and Regional Integration Strategy Papers should therefore make explicit provisions to analyse the potential of establishing SEZs and put this topic on the agenda for policy dialogue with concerned governments, private sector and development partners.
- 2 **Complement policy dialogue with targeted Technical Assistance to support the development of SEZ programmes from its initial inception:** The difficulties encountered in fragile situations in Africa in practice (see section 4) highlight the

need for quantitatively and qualitatively more technical support from development partners in these areas. And despite the challenges in fragile contexts, SEZs present a valuable option for African states in fragile situations to establish reform pilots on smaller scales that have the potential to diversify the economy and catalyse wider growth and economic inclusion.

- 3 **Invest in key infrastructure:** As shown before, an infrastructure offering was one of the success factors for SEZ programmes in Africa so far (see 3.2.1). Therefore, the AfDB should facilitate investments in these key infrastructures. Similarly to what Collier (2013) proposes, development partners could directly subsidize infrastructure in the form of pioneer investments by providing capital at below market rates (through equity or bonds), providing insurance (through agencies such as OPIC or MIGA), or actively partnering on the management boards of enterprises. Furthermore, isolation is one of the main impediments to investments in fragile contexts (see section 2.4). Facilitating investments in transport infrastructure can help reduce transport costs and integrate zones into the global economy. Another alternative is to leverage transport infrastructure developed by natural resource companies – frequently present in fragile situations – to allow for a multi-purpose use of this transport infrastructure. Additionally,
  
- 4 **Using intermediary firms to serve as investment facilitators:** As explained in the section on FDI in fragile contexts (2.4), information asymmetry is one of the major obstacles to investment facilitation in states in fragile situations. Understanding the local context is key to developing projects in fragile governance environments. To overcome the information asymmetry, as well as to absorb the fixed investor, sponsor, and transaction costs, CSIS (2013) proposes to fund an intermediary firm that serves as investment facilitator into SEZs. In countries experiencing fragile situations, this special purpose vehicle, which would be wholly or partly state-funded, and could be managed through performance contracts, would be incentivised to develop and promote the zone in a commercial manner. The greater the risk, the more the state and its development partners would be required to shoulder the initial, pre-commercial, burden. This corresponds to scenarios 1 and 2 in Figure 3 above. In very low state capacity situations, this arrangement may still be envisaged as a form of externalisation until commercial conditions are met. A management contract would be the best format.
  
- 5 **Apply the lessons learnt from early stages to re-structuring non-performing zones:** The lessons learnt from the early stages of policy design and implementation as described in this report are also valuable with regards to re-structuring non-performing zones in these contexts. As observed in section 4.1, zones in Africa mostly failed due to a changing international trade context and bad implementation choices by policymakers. The lessons and recommendations with regards to establishing more economic linkages and changing focus sectors in line with shifting international comparative advantages are also valid for already existing zones.

## Country level: How development partners can help overcome some of the challenges to SEZs in fragile situations in Africa

The following recommendations seek to inform support for policy formulation and implementation of SEZ programmes in fragile situations. These recommendations include:

- 1 **Political economy diagnostic:** Before engaging in support of a country's SEZ programme, development partners should apply a political economy diagnostic in addition to the usual economic analysis of that country that assesses the policy and technocratic capacity of the country's institutions that will be involved in the SEZ programme. The objective of this diagnostic would be to assess if the political economy situation is mature and stable enough and show whether the technical and financial means to make the necessary policy decisions on SEZs exist. The diagnostic should include an analysis of the vested interests that are likely to support and oppose SEZs, and determine if these interests can be accommodated. Such an analysis should principally be for internal purposes, while a 'lighter' version can be shared with the government as a discussion note around challenges that need to be addressed to ensure a successful SEZ programme.
- 2 **Emphasise preparatory phase:** When agreeing to support a country's plan to implement SEZs, development partners should focus on the importance of the preparatory phase of the process, and avoid rushing into technical work. This phase should include designing a realistic initial strategy rooted in solid political economy considerations, rather than the usual economic ones. This initial strategy should be based on wide consultations and leveraged to remove preconceptions that cannot be achieved in the country's current and likely medium-term future. This preparatory phase should be conducted with significant political, technocratic and private sector input, even if this is perceived as delaying the process. This should be followed by a comprehensive pre-feasibility study to determine the appropriate model, location and sector focus of the zone. This hedges against subsequent inconsistencies in the decision-making process and capture by vested interests (see 4.2.2). Key here is to create consensus, manage expectations, and introduce realism (notably around achievable timeframes and economic goals).
- 3 **Parallel regulatory track:** As fragile situations are characterized by weak institutional capacities, it is imperative to ensure that concerned governments have access to the necessary expertise to make informed decisions. The provision of targeted TA by donors could play an important role in this regard. Development partners' assistance should happen in two parallel tracks: the planning track and the regulatory track. This will inhibit problems as encountered in numerous African states in fragile situations where certain actors felt that they could not move forward with preparing the legal framework because there was no progress on the policy formulation aspect (see 4.2.2).

- 4 **Involve the private sector:** The inclusion of the private sector in the policy design and implementation process incorporates an important actor that can assume ownership over the process in cases of policy paralysis. As shown in the broader analysis on SEZs, the private sector can in some scenarios play a role in managing the zone, for example through PPPs, or enter into joint ventures with the government in certain zones (see point 4 in section 3.2.). Risks of capture should be managed through the results of the political economy analysis. An emphasis on the ‘carrot’ approach (focused on incentives) should be pursued in legislation and regulation in SEZs so that the private sector sees benefits in promoting job creation and improving linkages with the national economy. The ‘stick’ approach (e.g. through onerous regulation that creates additional costs or burdensome compliance procedures) can result in businesses seeing less reason to invest in a particular SEZ.
- 5 **Strengthen local private sector capacity:** As explained, the design of new SEZs supported by donors requests linkages between firms in the zone and firms outside of the zone. However, the local private sector might not necessarily have the capacity to seize these opportunities. Therefore, AfDB should adapt a holistic approach not only in the implementation of SEZ programmes, but also by increasing measures to strengthen the capacity of the local private sector in the host country of the envisaged zone.
- 6 **Emphasise constraints:** SEZs should not be viewed as quick fix tool for politically convenient investment opportunities and locations. However, SEZs must rather be viewed as a tool to address binding constraints such as infrastructure or land. Facilitation of investment should focus on what is economically viable in the country concerned, while also not excluding sectors identified by investors as being of interest (which may not originally have been identified by pre-feasibility or feasibility studies). This helps avoid the unrealistic expectations, as those described in section 4.2.
- 7 **Reach out to stakeholders:** This recommendation focuses on the need for development partners to continually engage with different kinds of stakeholders to raise awareness about the programme, its benefits, and different actors’ roles. The objective is to build a wider support base and a broader comfort level with the concept. Development partners can also assist in sharing information about the SEZ programme with potential investors (care should be taken in not favouring a SEZ programme in one country over another – particularly where countries are competing in the same sector).
- 8 **Support the establishment of a steering committee:** As seen in the example of Zimbabwe, one of the main difficulties in countries experiencing fragile situations is the lack of ownership due to insufficient technical and financial capacity (see section 4.2). There are often too many decision-makers with insufficiently defined roles and responsibilities. One of the ways to gain the broad institutional support

an SEZ programme requires is through the establishment of a steering committee. Such a steering committee can also help in identifying the right SEZ champions with the ability to exert the necessary influence over political processes. At the same time, such SEZ champions can become useful counterparts for the involved development partners. The AfDB can be seconded into such steering committees to help with policy design and early implementation, after which it can serve on an SEZ advisory board once the programme has been implemented and become operational. A useful option would also be for the AfDB to finance the establishment and management of these committees.

- 9 **Provide the necessary neutral guidance:** Key risks facing governments in fragile situations are politicisation of the SEZ development process, capture by vested interests, and lack of technical capacity (see section 4.3). Development partners should provide early neutral guidance to governments by deploying a small team of full time advisors that can provide support in the consultative process of strategy deliberation, engagement with the different branches of government, and supervision of technical work. The team should be deployed with the steering committee as well as with the executive office charged with the programme (Office of the President, Ministry, etc.).

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