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SUBMISSION

to the

DEPARTMENT OF TRADE & INDUSTRY

on the

SPECIAL ECONOMIC ZONES POLICY & BILL

March 2012

The government's initiative to create Special Economic Zones (SEZs) is particularly welcomed by the Free Market Foundation (FMF) which has distinguished itself during its 37 year history as the pre-eminent protagonist of SEZs. We have written extensively on the subject, studied SEZs around the world, and made submissions to successive South African governments.

A number of basic points are essential for any serious consideration of the matter:

1. **Most SEZs – there are thousands – are failures**
   "SEZ" is used here to connote all kinds of special zone and status intended to create especially attractive conditions that are distinguished from what otherwise applies in a host country.

2. **This includes South Africa's failed attempts at SEZs over the past half century**
   South Africa has had many SEZs such as apartheid "growth points", "border industries", industry-specific "export incentives", "temporary removal of restrictions" zones, and Industrial Development Zones (IDZs). Recent variations on the theme include Koega, Richard's Bay, East London and OR Tambo. These are all failures in that none have (a) attracted substantial profitable investment, and (b) most have consumed more wealth in the form of infrastructure, subsidies and concessions than they have produced in the form of genuine and sustainable profit.

3. **SEZs must be thought of as "offshore", that is, for relevant purposes, as not being in the host country**
   For SEZs to be taken seriously, both by those who create them and those who invest in them, they must be informed by an unambiguous acceptance that they are "offshore", which means that they should not be subjected to laws, policies and taxes that discourage, in the country as a whole, the kind of investment envisaged for SEZs. This is the most difficult reality for a government in any country to come to terms with. It is especially difficult in democracies to get popular support for the fact that foreign exchange controls, labour laws, taxes, immigration controls, minimum standards, and the like, cannot be applied in SEZs if they are to be successful.

4. **SEZs are not necessarily a geographic concept; it should be thought of as a status that can be conferred on any enterprise, whether in or out of a physical "zone"**
   Once the essential nature and purpose of SEZs is properly understood, it becomes clear that the crude concept of a physical place with fences and border controls, and teams of bureaucrats and consultants, is misplaced. All necessary controls to facilitate that from which SEZs are exempt, can quite adequately be achieved administratively at minimal cost by, for example, the requirement of specialised audits.

   SEZ administration and management is best outsourced or left to private competitive enterprise. There is every reason to believe that officialdom and bureaucracies are unlikely to be good at either identifying the ideal locations for SEZs or running them efficiently. Even if, as is typical in South Africa, they are run by government structures, many or most of the administrative and managerial functions can and should be outsourced. Needless to say, allowing private businesses to establish and administer SEZs, or undertake specified SEZ functions, entail ideal BEE and B-BBEE opportunities.

5. **New SEZs are at a conspicuous disadvantage being preceded by thousands of others, some of which have impressive track records and have gained the confidence of local and international investors**
   Only a small proportion of SEZs established in modern times have been successful in any meaningful sense. Most have been forgotten or abandoned. More seriously, most have been a

substantial drain on the host country's resources because (a) a considerable initial investment in infrastructure, administration and marketing is required, and (b) there is a reluctance to accept failure, which induces governments to make increasingly wasteful investments in a desperate attempt not to lose face. This has been a singular characteristic of South Africa's experience from apartheid "growth points" to Koega.

We appreciate that enormous investments have been made in South Africa's failed SEZs from homelands to harbours and that current policy will be heavily influenced by a desire for these investments to be vindicated. If it is at all possible, policymakers need to liberate themselves from this constraint, stand back, and look at the big picture with political will and vision. This may involve swallowing some bitter pills and locating SEZs in places that make objective and business sense, on one hand, and providing for SEZ status anywhere in the country, on the other. This is not to say that existing initiatives need to be abandoned. They may well, on purely objective grounds, be ideal. The point is that policymakers should be free from an assumption that they must be successful regardless of cost or other rational considerations.

A dimension to politics and discourse in South Africa that may fatally undermine a truly successful SEZ policy is the ease with which ideas can be proposed and taken seriously. This would be anathema to SEZ investors. Recent examples include the debate on nationalisation, the proposed prohibition of labour brokers, compromised property rights, erosion of the rule of law and the continued *de facto* prohibition of efficient energy markets.

Another big problem South Africa faces is a "one-size-fits-all" mindset. The notion that there must be policy uniformity throughout the country is a tragic legacy of apartheid. The apartheid regime established Bantustans on the pretext that there would be sovereign countries for each "nation" along the lines of Europe's "nation states" (France for French, Germany for Germans, Spain for Spaniards, Italy for Italians, etc). No sooner had the Bantustans been established, than the regime created costly "multilateral secretariats" with the principal purpose of enforcing uniformity, especially through centralised fiscal and monetary control. Whatever other flaws there might have been in grand apartheid, this aspect alone meant that it was an inherently dishonest policy, doomed to failure.

Post-apartheid South Africa is technically a "federation" in that it has exclusive and concurrent powers constitutionally devolved to provinces and municipalities. Yet, the apartheid mindset continues to dominate in that the idea of multiple systems within one country is completely alien to South Africans, notwithstanding a much vaunted Constitution to the contrary. Not only is there scarcely any diversity of substance regarding constitutionally exclusive powers and functions, but it is presumed that concurrent functions fall under central government rather than within the domain of provincial and local government.

The purpose of this point is to draw attention to the fact that most other federations of the world truly embrace the concept of federalism and regard the idea of multiple systems within a single country not only as acceptable, but as a distinctive strength, to such an extent that some second and third tier structures are essentially themselves SEZs. Zug in Switzerland, for example, is a tax haven; the entire Chinese province of Hainan is an SEZ; some major cities such as Rotterdam and Singapore are SEZs.

It is a misconception that SEZs are a modern concept. On the contrary, they have an old and illustrious history. Some ancient SEZs are famous even though they are not readily recognised as such in modern times. Four thousand years ago Egypt had SEZs. That great western civilisation, Greece, had city states, some of which were SEZs. Through the dark ages, there were anomalous centres of immense prosperity that were SEZs such as Franconian Free Cities and most of Ireland. Anthropological records show that

there were great centres of trade and finance that were SEZs such as Timbuktu in Africa and Uxmal in Mayan America. In more recent history, there were such centres of prosperity as Venice and the Hanseatic League. For most of recorded history there have been successful SEZs so there is no need to reinvent the wheel. All that is required to establish successful SEZs in South Africa is to learn from the clear, readily available lessons of history.

There are only two serious issues to be taken into consideration: (1) Whether we, as a country, are serious about wanting SEZs, in which case we should not beat about the bush and adopt timid measures which, it can be said with great certainty in advance, will not only fail, but will be a massive net drain on the country's wealth in that substantial initial resources will be invested followed by further investments in a desperate attempt to bring success where there is failure. (2) The fact that, as new kids on the block, we will have to compete with existing flourishing and popular SEZs. Investors will ask a simple and obvious question: "Why should I invest in an unproven, untested South African SEZ when I can invest in Shannon or Shanghai?" To attract significant investment in the face of such formidable competition, we have to offer at least the following:

1. **Guarantees of security**. Investors need to know that South Africa means business, that promised benefits will be enduring and sustainable, and that they will not be victims of undisclosed constraints. A novel way of providing such security was conceived by the FMF and successfully adopted by Lloyds of London, namely, to provide international offshore insurance against harmful changes of policy.

2. **Substantial relief from measures** that prevent targeted investors from investing already. This requires a serious and honest critical review of existing policies especially:

    a. ***Foreign exchange control***. The total abolition of forex control is, in our view, long overdue for South Africa as a whole. At the very least, no-one will take South African SEZs seriously unless they are totally and unambiguously exempted from exchange control.

    b. ***Labour law***. South Africa's SEZs must be exempted from onerous labour law. The most elementary and non-debatable law of economics is that **all benefits have costs** ("there is no such thing as a free lunch"). The cost of benefits conferred by labour law is, as with all benefits, imposed elsewhere. The most direct and obvious victims of making the hiring of people costly, risky and difficult, are the unemployed. Another substantial group of direct victims are, unlike the unemployed, invisible, namely investments that have <u>not</u> been made because cost-raising labour law renders them "marginal". Exemption from labour law will attract massive labour-intensive investments. (In this context, our comments are a reference to *economic* aspects of labour law rather than *social* aspects such as safety and "decent" treatment according to law.)

    c. ***Red tape***. There are thousands of statutes, regulations, ordinances, by-laws, proclamations, directives, guidelines, and the like, that are inappropriate in an SEZ. They are found in laws governing insurance, banking, companies, immigration, customs, transport, energy, skills and communications. SEZs should be exempted from these. We mention only three illustrative examples below. What the following measures have in common is that they are intended to benefit and protect consumers. They may well do so, but what is not generally recognised is that they do so by radically reducing consumer rights, namely, the right of consumers to negotiate and enter into whatever agreements they wish.

Consumer Protection Act (CPA)
The CPA is praised by virtually all commentators by virtue of its seemingly lavish benefits for consumers. However, every benefit enjoyed by consumers is paid for by them and the question to be asked is whether consumers would be so willing to pay the price if they knew that this is what they are doing. Consider one of the provisions in this context, namely, the prohibition of *voetstoots* sales. This has the seductive though disastrous effect of every product bought by a consumer carrying a full warranty against defects at the time of sale or arising within six months, thus raising the cost. In other words, the Act completely and fatally prices low-income consumers out of the market.

National Credit Act (NCA)
Regarding the NCA, its effects are similar. The greater cost, risk and difficulty of granting credit has the necessary and unavoidable impact of driving low and middle income people out of the market for credit. For them, the doors have shut. They have been driven back into the hands of loan sharks that characterised apartheid era credit laws.

Financial Advisory and Intermediary Services Act (FAIS)
The FAIS Act also raises the cost, risk and difficulty of providing financial products and services, which means that all marginal businesses, products and consumers are driven from the (lawful) market.

3. **Property rights**. Presumably, it is obvious that SEZs should have (a) secure and (b) freely tradable property rights. We trust that there is no need for this point to be elaborated. We do, however, repeat the idea that property rights can be secured by international insurance to offset doubts that have been generated and will continue to be generated by loose talk in South Africa about the need to erode property rights, on one hand, and the failure to extend full freehold title (without "preemptive clauses" and the like) to all property holders in predominantly and historically "black" areas of South Africa.

4. **Rule of law**. It will not be obvious to most readers what the rule of law point refers to, so, by way of example, we address this point briefly. The foundational principles of South Africa's Constitution is enshrined in the first section and includes the rule of law. Sadly, "the rule of law" has become a cliché. Virtually everyone is for it yet hardly anyone knows what it means in practice. Very few people, including jurists, can tell when a specific measure violates the rule of law. It consists of three main elements: (1) separation of powers; (2) general application; (3) certainty and objectivity. Discretionary power – the right for officialdom to grant or withhold favours arbitrarily – violates the principle of certainty and objectivity. The Asset Forfeiture Unit established under the Prevention of Organised Crime Act is an extreme example of discretionary power that violates the rule of law (as found by the Constitutional Court in the Mahunran case). Another common place example of inconsistency with the rule of law is the tendency to erode the separation of powers by the creation of quasi courts and adjudicating tribunals in the executive branch of government instead of where they belong, in the judiciary. There should be special attention given to the proper application of the rule of law in SEZs.

5. **Energy**. There is insufficient appreciation in South Africa of how serious the electricity crisis is. South Africa lost R130bn in a single year. That wealth is lost, along with compound interest, forever. Electricity inadequacy and insecurity imposes an absolute cap on South Africa's ability to grow. All high-growth economies must have (along with other preconditions) adequate and secure electricity including additional generation sufficient to meet increased demand. In almost all cases this has been achieved by having functioning energy markets. The National Development Plan

(NDP) proposes the separation from Eskom of system operation and acquisition. It is clear that Eskom's "new build" (mainly Medupi and Kusile) is costing more and taking longer than promised. It is also clear that the new power stations will cost still more and take still longer than revised predictions. More importantly, it is clear that existing entry barriers are preventing Independent Power Producers (IPPs) from entering the market and preventing trade in energy whereby people with higher demand can satisfy their needs by paying more and people with lower demand are induced by higher prices to cut consumption. In the circumstances, energy policy in any SEZs should allow complete freedom to generate, distribute and trade in all forms of energy (electricity, liquid fuels and gas).

SEZs will work, if you allow them to.

For more information, please see the annexures below:
Annexure A: Job Creation Zones
Annexure B: SEZs in China: China Syndrome
Annexure C: The rule of law under siege in South Africa?

Please note: We would like to make an oral submission on this important issue.

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About the Free Market Foundation (www.freemarketfoundation.co.za)

The Free Market Foundation (FMF) is an independent policy research and education organisation founded in 1975 to promote the principles of limited government, economic freedom and individual liberty.

The FMF argues for respect for the Constitution, proper application of the rule of law (which is enshrined in the Constitution), high economic growth as the best means of alleviating and reducing poverty, and economic freedom as the best means of achieving an improvement in all aspects of human development.

The FMF is a voluntary association. It receives funding from members (corporate, organisational and individual), sponsorships and the sale of publications.

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Annexure A: Job Creation Zones

Extracted from Nolutshungu, Temba A / Louw, Leon, ***Jobs Jobs Jobs***, Free Market Foundation, November 2011

Executive Summary

Special Economic Zones (SEZs) have been one of the most effective means of attracting billions of dollars of investment and employing millions of people who enjoy rapidly rising living standards.

It seems that with SEZs, any country can easily attract enough investment and technology to eliminate unemployment. That may be how it seems, but the reality is quite different. Most SEZs are failures. Why have most SEZs failed and why are others successful?

Since 1980, the number of SEZs known to the World Bank has escalated from around 100 to over 2,300 in more than 120 countries all in search of illusive job- and wealth-creation magic without the requisite degree of understanding of what are the determinants of success, and, more importantly, failure.

This chapter sets out to clarify what the determinants of success and failure are, and suggests two distinctive types of SEZ for South Africa. The internationally proven way to create many jobs quickly is to create SEZs 'with clout'. There is no need to reinvent the wheel, and no need to repeat errors, given what is now known.

Job Creation Zones

Special Economic Zones (SEZs) have been one of the most effective means of attracting billions of dollars of investment and employing millions of people who enjoy rapidly rising living standards. It seems that with SEZs any country can easily attract enough investment and technology to eliminate unemployment.

That may be how it seems, but the reality is quite different. Most SEZs are failures.

There are few issues of great importance which have induced as much muddled thinking followed by as many costly mistakes as SEZs. If South African policy-makers learn the lessons of the world's SEZ experience – its few successes and many failures – the country could enjoy rapid job creation at a faster rate than hoped for by the government.

Why have most SEZs failed and why are others successful? Some SEZs were so spectacularly successful that they transformed entire countries (e.g. China, Mauritius, Emirates), whilst most of the others never amounted to much, often consuming enormous amounts of wealth (e.g. Myanmar, Namibia, South Africa).[1]

The conspicuous success of a few SEZs led to the naive notion that by creating an area called an SEZ (or something like it)[2] the desired outcome would result. But desire is not enough. No matter how passionately politicians say they want things to happen, they will not happen unless the requisite policies are understood and implemented.

Since 1980, the number of SEZs known to the World Bank has escalated from around 100 to over 2,300 in more than 120 countries all in search of illusive job- and wealth-creation magic without the requisite degree of understanding of what are the determinants of success, and, more importantly, failure.

Applying an expanded definition, the World Federation of Free Zones (FEMOZA)[3] reported that there are 3,000 to 4,000 special status areas, an average of twenty per country.[4]

The ILO estimated in 2002 that there were 45 million people employed in SEZs, the equivalent of South Africa's population at the time.

Whilst fact-finding missions, including from South Africa, often visit winners, none investigate losers despite there being many more to visit. Virtually no attention is paid to the escalating number of SEZs that are failing. Even where policy-makers know of their existence, they are ignored. Some failed SEZs have been discontinued or abandoned. Instead of admitting failure, some governments have spent huge amounts of money trying to force success, thinking the solution to failure is more of what failed, especially more money by way of infrastructure, subsidies, concessions and the like.

This chapter sets out to clarify what the determinants of success and failure are, and suggests two distinctive types of SEZ for South Africa, (a) 'offshore zones' for large-scale international investment and employment, and (b) 'job creation zones' to promote jobs and development in impoverished areas.

That just one of China's seven SEZs (Shenzhen, for instance) creates as many jobs in a single decade as the total number of unemployed South Africans whilst raising incomes from below to four times the national average places the enormous potential of SEZs in context.

During the 1970s, Shenzhen was a small town by Chinese standards with 300,000 residents. It now has a population of 12 million with average incomes of over US$8,000 compared with a national average of US$2,000. Its GDP of around US$100 billion is nearly a third of South Africa's of some US$350 billion. In other words, a single China-type SEZ could absorb all our unemployment and increase the living standards and incomes of our poor and unemployed compatriots to more than our national average of around US$5,000.

There is a fair amount of information readily available on SEZs, which, if properly understood, provides clear guidelines, such as that published by the World Free Zone Convention. The WFZC holds annual conferences which have been attended by delegates from 127 countries including South Africa.[5] Various studies and books have 'guidelines' and 'lessons' to be learned.

As always, there are some rather silly critiques. Typically, they state that prosperity within SEZs is not enjoyed by everyone in the country. They point to poverty elsewhere and imply that the new-found wealth of some is, as if by magic, the cause of the poverty of others. This myth is a familiar refrain in South Africa. That millions of blacks are substantially better-off thanks to the end of apartheid is turned into grounds for lament because millions of other blacks are still destitute.

Another argument relies on referring to failed SEZs without acknowledging successes, or failing to explain why they failed and the others succeeded.

There are distinctive challenges for newcomers. It is not good enough to do what winners did years ago. Countries that closely mimic what winners did often fail for the very simple reason that when investors choose between two similar investment environments, they are likely to choose the one with a track record. In order to 'play catch-up', latecomers have to offer some or other new comparative advantage.

Calling ourselves 'the gateway to Africa', as South Africans love doing, is unlikely to attract a dime of serious investment. This is especially true if we persist with archaic foreign exchange controls and labour laws that make it difficult or impossible for multinationals to establish regional head offices here; they

would rather go to a country from which and into which they can freely and immediately transfer funds and personnel as needed.

Starting well after China, India realised when it decided to create SEZs during the 1990s that it would have to offer something more and/or different. India, therefore, built on the celebrated success of its progressive and transformative 'pro-market reforms'. It now has SEZs specialising in different niches, the best known of which is the information technology industry mainly in Bangalore and Hyderabad. Rajendra Singh, Executive Chairman, SKIL, Maha Mumbai SEZ lists critical regulatory aspects thus[6] (author's summary):

- An SEZ is a "specifically delineated duty-free enclave ... deemed to be a foreign territory for the purposes of trade operations, and duties and tariffs".[7]
- 100 per cent income tax exemption for 10 years.
- Duty free imports.
- Access to cheaper global capital.
- Exemption from income / capital gains tax.
- Retail investment tax rebate.
- Special courts.
- Dedicated police.
- Speedier labour dispute resolution.
- No customs on raw materials, capital goods, etc.
- 25 year tax exemptions from state and regional taxes (turnover tax, sales tax, value added tax, entertainment tax, excise tax, etc).
- External Commercial Borrowings (ECBs) allowed.
- Freedom to retain or trade foreign exchange earnings.
- 100 per cent income tax exemption for first 5 years, 80 per cent thereafter forever, for Offshore Banking Units (OBUs) in SEZ.
- 100 per cent FDI allowed through automatic approval route.
- Sub-contracting allowed to units in Domestic Tariff Area (DTA).
- One-stop shop regulatory system.
- 'Public Utility' status thus preventing flash-strikes.
- Freedom to trade power without going through State Electricity Boards.

This is not the full list. It illustrates the areas addressed to make it maximally attractive for employers and investors, and the attention to detail. Benefits are constantly revised and improved as the need arises. Proven benefits are listed as:

- Poverty alleviation.
- Employment generation potential.
- Development of backward areas.
- Better education.
- Better health care.
- Improved infrastructure.
- Advanced technology.
- Quality of life boosted.
- Enhanced incomes in the region.
- Regional development.

The study suggests reasons why many SEZs fail:

- Inefficient land acquisition.
- Political instability.
- African countries EPZs.
- High crime rate.
- Excessive corruption and administrative burdens (Hainan, China).
- Administrative delays (Ghana, Senegal).
- Failure to develop backward linkages (Ghana).
- Lack of reliable infrastructure (Dominican Republic).
- Macroeconomic policy failure (Egypt, Kenya).
- Poor location (Bataan, Philippines).
- Poor infrastructure.
- Bureaucratic bottle-necks.
- Frequent changes in policy.

SEZs are not a new idea. Records of areas prospering by virtue of being relatively free of inhibiting controls and taxes applicable in surrounding areas date back to the ancient Sumerian city-state of Lagash (2300 BC). There were 'free ports' in ancient China, Greece, Rome and Medieval Europe, such as Germany's prosperous city-states called 'Franconian free cities', and the 'Hansaeatic League'. Venice and Florence were free cities in renaissance Italy.

These fine examples of how to promote prosperity were emulated by modern SEZ exemplars Singapore, Hong Kong, Shannon and Dubai. Most of the world's countries now have areas and/or enterprises governed by special provisions, particularly tax and regulatory alleviation.

Other factors associated with failure include:

- Businesses which may be established outside SEZs being threatened by competition emerging from SEZs.
- Consultants to governments which require less of their services when there are controls and functions requiring their services (unless they have special SEZ expertise).
- Officials who share the interests of politicians and who have a natural propensity to build 'bureaucratic empires' that provide for and control citizens.
- NGOs engaged in development projects for needy communities no longer in need of their support by virtue of spontaneous prosperity.
- Politicians who benefit from power, status and patronage if they have more power and if citizens are dependent on them instead of independently prosperous.
- Unions which may be undermined by conditions where incomes and living standards are driven up by self-employment and increased competition for labour rather than themselves.

Beyond these, there are many important considerations, such as the risk of economic dislocation and distortion due to not having uniform conditions in the country – the obvious question being why conditions sufficiently advantageous to bring about prosperity in high density areas should not be applied throughout the country. These and other considerations are addressed in this report.

The ILO lists the following reasons for having SEZs (verbatim):

- Create jobs and raise standards of living.
- Transfer new skills and expertise to local human resources.

- Boost non-traditional exports and export sector.
- Increase foreign exchange earnings.
- Create backwards and forwards links to increase the output and raise the standard of local enterprise that supply goods and services to the zone investors.
- Introduce new technology.
- Develop backward regions and attract industries.
- Kick-start the economy as a whole.
- Stimulate strategically important sectors of the economy.

By virtue of China's success with SEZs, they have become like a drug. The original idea appears to have been inspired by the communist Chinese regime's envy of the success of the two Chinese 'Asian Tigers', Taiwan and Hong Kong. The idea was to establish counterparts within communist China. The paradox is that, in doing so, a nominally communist regime established what are probably the world's most extreme free market capitalist systems. Early success got the regime addicted to the SEZ drug, so it (a) developed a range of variations on the theme, which have such names as 'economic and technical development hubs', 'key economic hubs', 'open cities', 'free ports', and 'export processing zones', and (b) started expanding the concept from the South-East coast (near Hong Kong and Taiwan) towards the impoverished hinterland and North-West. For practical purposes, China's addiction to SEZs has turned the notion of communism on its head.

Ghana is one of a growing number of countries outsourcing and decentralising SEZs. Investors can obtain 'free zone status' for business wherever they happen to be, or in a designated zone.

Notwithstanding the proven success of SEZs with the correct formula, there remain many sceptics in South Africa. The SEZ concept 115 has been considered in South Africa from at least as far back as the early 1970s, but, for various reasons, mostly resistance from self-serving vested interests, the country has missed many opportunities to benefit from the global special zone/status revolution.

Part of the problem has been mis- and disinformation such as supposedly true axioms asserted by such influential and credible people as Zwelinzima Vavi, General Secretary of the Congress of South African Trade Unions (COSATU): "In no country has it been shown that free trade zones are a real path to development". According to this profoundly misinformed view "Investment comes and goes, usually leaving little behind once it has gone".

In truth, SEZs, especially when properly conceived, that is when they have substantial benefits, are enormous wealth and job creators, with happy investors increasing their investments rather than 'leaving', and even attracting additional new investors.

The case for SEZs as a means of promoting employment and prosperity is now so clearly established that it can no longer be seriously debated. But the idea has a special potential for South Africa since it can be adapted for depressed areas, mostly old homelands and other historically black areas.

One of South Africa's most promising and creative measures, potentially of enormous relevance and of which scarcely anyone is aware, is the Temporary Removal of Restriction on Economic Activities Act (87 of 1986) that South Africa used to create successful SMME special zones. Curiously, this Act fell into disuse, despite its early promise, but the idea can easily be revived and expanded.

We propose that in addition to internationally competitive 'highend' SEZs, there should be a special zone formula for depressed areas. It can be thought of as reversing apartheid. Whereas apartheid imposed extreme restrictions on black areas, the post-apartheid regime can go the other way and have the extreme

removal of restrictions. Such areas can have tax holidays and exemption from many laws and red tape. Once the principle is under consideration, there can be detailed analysis of specific reforms. The Free Market Foundation has published detailed proposals, too long to repeat here, that cover the following categories:

- Building codes.
- Business licensing.
- Credit.
- Consumer affairs.
- Financial and Intermediary Services (FAIS).
- Financial institutions.
- Land tenure.
- Land use (zoning).
- Labour.
- Minimum standards.
- Occupational licensure.
- Property development.
- Small Business is Big Business.
- Tax.
- Transport.

The internationally proven way to create many jobs quickly is to create SEZs 'with clout'. There is no need to reinvent the wheel, and no need to repeat errors, given what is now known and the apparent ease with which the world's poorest countries such as Hong Kong, Taiwan and Japan before, and China, India and Mauritius more recently, took off into a world of full employment and rapidly rising living standards.

Whether we solve our problems is not a matter of destiny, it is a matter of choice. Our government has a simple choice: do what is known to perpetuate stagnation or do what is known to produce prosperity for all.

1 Thomas Farole: Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience, World Bank, 2011.
2 Other terms include export processing zones, free ports, urban renewal, open cities, offshore facilities, financial centres, technical and development hubs, growth points, community empowerment areas, and so forth. Sometimes long unwieldy names are adopted, such as Community Renewal Initiative for Renewal Communities and Urban Empowerment Zones (USA). Often terms are used interchangeably as in Nigeria where special areas are called 'epzs', 'ftzs' and 'Free Zones' interchangeably.
3 www.free-zones.org.
4 For an index of some SEZs see http://www.escapeartist.com/ftz/ftz_index.html.
5 The WFZC, like the World Bank, offers training and consultancy services. www.freezones.org.
6 Rajendra Singh, Executive Chairman, SKIL, Maha Mumbai SEZ, An Enabling Environment and Economic Zones for Private Sector Development in Bangladesh Lessons Learned in South Asian Free Zone Implementation, BangladeshRT2Topic4Singh-paper.pdf, International Finance Corporation, 2004.
7 EXIM Policy 2000, Chapter 9 Para 30.

Annexure B: SEZs in China: China Syndrome

Extracted from: Louw, Leon, ***Habits of Highly Effective Countries: Lessons for South Africa***, The Law Review Project, October 2006.

China has the world's most interesting and potentially most instructive economy. One in four of the world's population live there; it has the world's highest sustained growth rate – if official figures are to be believed – and, if it continues growing at present rates, it will soon be the world's biggest economy. Within a generation, it will account for half the planet's GDP. It seems destined to become the world's dominant 'super power', at least economically.

Discourse about China is reminiscent of debates during the 1970s, 1980s and 1990s about the 'Asian Tigers' (Japan, Taiwan, Hong Kong, Singapore and South Korea). They were the world's highest growth economies, and people of every persuasion claimed them as examples of *their* system outperforming alternatives. Initially, capitalists and socialists disagreed about which countries were succeeding, but the view that socialist economies were more successful, especially those with extreme forms of socialism and communism, became unsustainable after the collapse of international socialism at the end of the 1980s.

Both sides now claim China as an example of their system succeeding. Many commentators predict that the Chinese 'bubble' will burst. Meanwhile every observer is dazzled, and no one seems to be sure what to make of the phenomenon. Close on China's heels is India, also rising from the ashes of a century of mass destitution at extraordinary growth rates. Maybe concerns about the sustainability of these two impressive growth rates is misplaced, given the enduring nature of spectacular growth over many decades in such so-called economic miracles as the Asian Tigers, Ireland and Mauritius.

Because of its unique significance, we wondered whether China really is a special case, and reached the surprising conclusion that, not only is there nothing conspicuously distinctive about China's success factors, but that it is perhaps *the* definitive exemplar of which policies coincide with which outcomes.

China's growth is consistent with and predicted by its economic freedom score, rather than its civil and political liberties score (FH). It does indeed grow faster than its nominal economic freedom score predicts, but that is typical of what happens when countries move 'in the right direction'. They often experience an 'acceleration effect'.

Conversely, countries that are relatively free but increasingly less so, tend to contract disproportionately. Zimbabwe is an obvious example. Its economy started deteriorating before it slipped from modest levels of economic freedom during its first decade of independence to now being one of the least free economies in the world.

What we found is of considerable importance for policy makers. Firstly, China cannot be thought of as a single economy or even as a single country as far as its economy is concerned. The diversity of economic systems within China, from one province to another, is bigger than the diversity of economic systems internationally. Secondly, almost all its growth (industrialisation, investment, etc) is not only confined to provinces with high scores on the 'marketisation index', but to a few special zones. Thirdly, these zones have the freest economies on earth, if not the freest economies the world has ever known.

These are dramatic statements. We do not make them lightly, and took great care to check our facts.

Given the extreme multiplicity of economic systems *within* China, it can be thought of as the world's most federal country, that is, as the country with most internal diversity and devolution of power. Given

these extreme differences, China is, for present purposes, close to a controlled experiment in social science. It is possible to see how diverse systems compare within a single country with most potentially confounding variables constant. Reliable data is notoriously difficult to obtain in China, but to the extent that it is available, economic performance varies as widely as and in sympathy with economic diversity.

China's freest province (Guandong) is nearly as free as the world's freest economy, Hong Kong, and its least free province (Qinghai) is less free than the world's least free indexed country, Myanmar. In other words, China has a bigger range of economic systems internally than the world has internationally.

The great diversity of systems within provinces explains only half the story. Almost all China's prosperity, especially capital formation (investment,) is in a wide variety of special zones in the South and East. The most important of these are five *Special Economic Zones* (SEZs), followed by three *Key Economic Hubs* (KEHs), and thirteen *Economic and Technical Development Hubs* (ETDH). The SEZs are probably the freest economies on earth, and may be the freest economies that have ever existed. They have extended tax-free holidays and, for practical purposes, no labour, competition, consumer, licensing or minimum standards laws. There are no trade barriers or foreign currency controls, not even reporting requirements. In the absence of accurate data, there is no needless anguishing about the "balance of payments" or "foreign debt".

Other special zones and special status attaching to individual enterprises include *Open Cities*, *Free Ports*, *Export Processing Zones* and *Special Economic Status*, each of which has distinctive characteristics.

Not surprisingly, variations in living standards, and in regional or geographic product (GGP), are extreme, ranging from areas with annual growth rates often exceeding 20% to backward areas in the hinterland and north-west where people live in primitive conditions. Encouraged by the fact that wealth has been doubling every three to four years in the most successful areas (since the concept was introduced in 1979), the government has been increasing the number and diversity of zones throughout the country, to the point where practically all workers will be able to access new jobs with rapidly rising incomes and improving working conditions.

The evidence is compelling that China's extraordinary success is explained by its extreme internal diversity combined with the dramatic increase of economic freedom in selected areas (especially in the South-East). By virtue of localised increases in economic freedom, the country as a whole is, on average, more free, its marketisation index having increased from 4.87 in 1999 to 5.98 in 2002.

China's policy reforms predict its rapid progress towards modernisation.

Like South Africa, China has moved towards greater trade openness, but much more so. The next chart shows China's average trade openness. Some special zones have no tariff protection.

There is a widespread belief that globalisation harms African economies by way of cheap imports with which they supposedly cannot compete. Why African industry should not, with its abundant human and other resources, be competitive, is unclear. China is regarded as the most serious threat to Africa's indigenous industry but its imports from Africa have increased at roughly the same rate as its exports to the continent.

Many of the facts about China are also true of India. The new economic freedom index for India's states seems to explain their varied performance. States with freer economies are growing at faster rates than the national average, while less-free states stagnate.

The high-growth counterpart of China and India in Africa is South Africa's neighbour, Botswana. In some senses it is an even more impressive success story. Like China, Botswana is achieving sustained high growth at rates in excess of those that coincide with its economic system. As with China, this appears to be a function of the acceleration effect described above. Botswana has been followed by Uganda, and, more recently, Tanzania and Mozambique.

The first African country to become an 'economic miracle' in recent times is Mauritius. Twenty-five years ago, it was one of the poorest countries on earth. It is a small, remote island in the Indian Ocean off the east coast of Africa, without resources. At the time, it was considered a hopeless case that would be in of need of foreign aid indefinitely.

Its government implemented policies that we now know coincide with high growth, and it was rewarded accordingly. It became Africa's first 'economic miracle' and achieved high living standards with full employment.

Annexure C: The rule of law under siege in South Africa?

A presentation by Leon Louw, 17 March 2005

The rule of law is fundamental to South African law. It is enshrined in the first chapter and first section of the Constitution. It is a binding Founding Provision. Section 1(c) provides for the "supremacy of the Constitution and the rule of law". Despite its pivotal importance for South African law, there is little understanding of what it means, especially for many law-makers. This is one of the legacies of the apartheid era. True transition requires the cultivation of a clear understanding of what the rule of law means in practice; its implications for conceiving of and drafting legislation and regulations.

"The rule of law" is distinguished from "the rule of man". What that means is that everyone's rights and duties must be readily apparent from the law and not subject – or subject only in exceptional circumstances – to discretionary power. It also means that substantive laws must be legislated ie made by an elected, transparent and accountable legislature. They must be executed by the executive, and adjudicated by an independent judiciary. Regulation – sometimes called "subsidiary legislation" inappropriately – should not be thought of as an alternative way of making laws.

Power should be delegated only to the extent needed to execute and implement substantive law (legislation and common law).

The challenge facing South Africa is to have a fundamental break from the apartheid-era mindset in which there was no constitution requiring adherence to the rule of law – parliament was sovereign; it is now an organ of state. A tradition was established according to which almost all legislation amounted to a delegation of illegitimate power to the executive. The three basic functions of government – legislative, executive and judicial – were systematically conflated into an omnipotent, and consequently abusive executive. The legislature, and thus elected and supposedly accountable politicians, became increasingly marginalised and irrelevant. Legislatures at all three levels – national, provincial and local – merely "rubber-stamped" whatever the executive, usually a single minister, wanted. South Africa's transition has been an extraordinary process, often called "the miracle of transition". By observing that it is incomplete, I do not trivialise it. On the contrary, it will be undermined if it is not completed by a change in mindset that translates the constitution and the values that inform it into a living reality, where there is spontaneous recognition of measures that are inconsistent with the rule of law in particular, and other constitutional provisions and values in general.

Apart from the philosophical reasons for this "separation of powers", to prevent the over-concentration of power, there are profoundly practical reasons for it. The legislature operates in accordance with elaborate procedures prescribed by the Constitution, and followed according to Parliamentary convention. These procedures are appropriate for law-making in a democracy. They ensure transparency, accountability, debate, participation and due consideration. They ensure that substantive laws are made by elected politicians.

Regulations, on the other hand, can be gazetted arbitrarily. That they are sometimes preceded by public discourse, or presented to the cabinet, is a matter of discretion, not a requirement of the Constitution generally or its rule of law provision. For this reason regulations should be confined to formalistic measures needed to implement substantive legislation adopted by legislators.

A second practical reason for rigid adherence to the separation of powers principle is that it is the only sustainable way to contain the natural propensity of officials to draft laws that shift power over time from politicians to officials. Their spontaneous inclination is to promote their interests, namely to formulate

laws that enhance their powers, status and incomes. Doing so gradually transfers the de facto legislative function from politicians and parliament to the executive, thus eroding democracy itself. Only if there is critical awareness and vigilance amongst politicians, will the erosion of their powers, the rule of law and democratic values be averted. Most mature democracies and, increasingly, developing countries, ameliorate the problem by having all laws drafted and screened by an autonomous central drafting agency, with trained experts in Constitutional Law.

The third practical reason for strict adherence to the separation of powers doctrine is that executive discretion is the main cause of real and suspected abuse of power, especially corruption. It necessarily generates intolerable and irresistible opportunities and temptations for the abuse of power. The failure to recognise this in South Africa and virtually all less developed countries is the principle reason for disproportionate levels of corruption in the third world.

There is no rigid or obvious boundary between legitimate legislation and regulation. But there are clear values and principles embodied in the rule of law that should be appreciated, respected and observed automatically; as a national mindset or ethos. Regulators – usually ministers in their executive capacity – should not "sail close to the Constitutional wind". They should not get away with as much as they can. There is no need for regulations to test the limits, and they should seldom if ever be the subject of legitimate Constitutional challenge. Acts should be drafted so as to contain all substantive law. Legislators must decide and debate in public what laws they want. Excessive discretionary power is undesirable in practice. It is an inferior way of making law. It is unsound philosophically; at variance with democratic values.

The separation of powers component of the rule of law has two dimensions. It prescribes and proscribes what may or must be in statutes, on one hand, and in regulations on the other. A statute or a regulation may be ultra vires, the former for one and the latter for two reasons. If an Act purports to delegate more power than allowed, it is, to that extent, unconstitutional, regardless of whether the power delegated putatively is used by the executive. Regulations are unconstitutional if they exceed what is authorised by their parent statute, and, even if they accord with it, they are unconstitutional if the delegated power is excessive or ambiguous.

The Constitutional Court has ruled that it must be clear from legislation why powers are delegated – to what end are they to be executed. They must also be accompanied by objective criteria for implementation. Delegated power cannot be implemented capriciously or according to the arbitrary whim of the executive. Statutes must provide clearly and unambiguously for how officialdom must or may exercise powers, and what, precisely, citizens must do to remain within the law. Citizens should not find themselves at the mercy of arbitrary or discretionary power. They should be able to establish with certainty from relevant statutes what their substantive rights and obligations are. What they must do procedurally for the implementation of laws is the legitimate substance of regulations. Typically, regulations should do no more than prescribe formalities: forms to be completed, office hours, registration fees, and the like.

Many new acts, like there apartheid-era predecessors, do not specify the purpose for which it purports to delegate the power under which the draft regulation is contemplated. They do not always specify objective criteria for implementation. To that extent they are or should be found to be unconstitutional. Even if they are constitutional – if the Constitutional Court interprets the Constitution generously, they are certainly undesirable according to the principles of good law.

A requirement of the rule of law is certainty: people are entitled to "know where they stand" so to speak. This is an obvious derivative of the rule of law. If there is no certainty, discretion rather than law rules.

Uncertainty in law creates real or suspected injustice, and increases the probability of bureaucratic inefficiency.

The aspect of the rule of law usually mentioned first in texts on it is the doctrine of equality: that laws must be of general application (an explicit requirement of our Constitution) and apply equally to all. For obvious historical reasons our Constitution allows measures to protect and advance people who are disadvantaged as a result of unfair discrimination.

En passant it should be noted that the Constitution does not refer to race or to people who were "historically" disadvantaged. In other words, it applies to people presently disadvantaged regardless of when they were discriminated against unfairly, which could be in the distant future. A careful reading of the relevant provision raises important jurisprudential questions regarding prevailing practices and policies many of which may be per se violations of the foundational rule of law requirement of equality, without necessarily being legitimised by the exception.

Understandably, there is a propensity to presuppose that the equality requirement of the Constitution refers to racial equality – that targeted discrimination is racial. The challenge to the rule of law of this myopic interpretation is that equality in other senses may be compromised. There are many examples. Most South African legislation and regulation is from the past. There have, for instance, been about 1,000 new acts of parliament since 1994 whilst there are over 3,000 acts still in force. Much if not most pre-transition legislation contains provisions inconsistent with the rule of law. Many post-transition laws also reflect a lack of appreciation of or respect for the rule of law – because of the extent to which the pre-transition mindset survives amongst all concerned with law-making: including legislators, government officials, judges and magistrates, lawyers, NGOs, and representatives of civil society (organised business and labour particularly).

A seminal example that bridges the past with the present is the Consumer Affairs (Unfair Businesses Practices) Act. It is a reincarnation of the harmful Business Practices Act. Like its predecessor, the new Consumer Affairs Act has extraordinary provisions. It purports to permit the executive branch of government to ban virtually any business practice, which is so broadly defined as to include almost anything anyone does in pursuit of income. Some formalities are prescribed but they are nothing like what is required of the legislature should it want to ban a business practice. In other words, the Act purports to give the executive more law-making discretion than the legislature enjoys under the Constitution.

Additionally, the Act purports to grant the executive an unbridled right to discriminate, a right which is exercised routinely. The net effect is that the executive makes substantive laws, applies them arbitrarily to individual businesses or people (instead of generally to all people), and undertakes quasi-judicial proceedings amounting to a usurpation of the judicial function. Whilst it is required to follow some aspects of the rule of law requirement of due process, it need not and does not comply with the high standards taken for granted in the judiciary, where people have the right to know who their accusers are, of what they are accused, what law it is they are supposed to have violated, the right of access to all relevant information, the right to be present, the right to cross examination, the right of review and appeal, and so on, none of which is applicable to proceedings under the Act.

A derivative of the requirement of legal certainty – the right to know the law – is that laws should not be retroactive. It is obviously inconsistent with the rule of law – you are not being ruled by the law – if you cannot know at the time of doing something whether it is lawful. The Act purports to grant the executive the power to rule tomorrow that what you did today is unlawful even though there was no way of knowing it. In theory, the activities of the Dutch East India Company in 1652 could today be declared retroactively unlawful.

Retired UCLA Professor Emeritus, John Hospers, used to use South Africa's consumer affairs law in his jurisprudence course as an exercise for students to identify the contravention of every principle of the rule of law in a single short act.

Similar powers exist under an increasing number of laws such as the Financial Advisory and Intermediary Services Act and the proposed National Credit Bill.

One of the most extreme is the Prevention of Organised Crime Act (POCA), known popularly as the asset forfeiture law. As always, the law was defended with persuasive rhetoric to the effect that abnormal powers are necessary to fight "international organised crime". When rule of law protagonists queried the extraordinary powers in the act, they were told that the government needs to be "tough of crime" – a sentiment shared by almost everyone, which is why there is widespread support for the law. And we were reminded that similar powers exit in the USA. This latter point has become a mantra to legitimise all dubious laws … as if the United States is our benchmark for what ought to be done during our transitional towards being a mature democracy. This is nearly as bizarre as the tendency to justify dubious things done now on the grounds that they were done under apartheid.

Advocates of the rule of law warned that power corrupts and that powers intended to protect us from large, sophisticated and dangerous crime syndicates would be used against ordinary civilians, which is precisely what's happening. As far as I know the legislation has never been used to seize the assets of international crime syndicates. Instead it is used to take the assets of ordinary innocent civilians.

Consider Mr Kleinbooi, an employee on the Laingsburg Municipality. He is suspected of drunk driving, but not yet convicted, and therefore to be presumed innocent. It turns out that there are many curious facts, such as that blood samples were taken long after his two alleged offences. However, when considering the rule of law it is important not to be diverted from basic principles by context-specific anomalies. The Act purports to give officialdom virtually unbridled arbitrary power to take all or any of any citizen's assets whether or not the person has committed an offence. All your wealth could be seized without you ever having committed an offence, or ever being charged, under conditions that would make it impossible for practical purposes for you to defend yourself.

These are not all the elements of the rule of law; only those that are presently least understood and therefore under greatest threat. There are essentially two ways of addressing the problem, firstly for government to continue enforcing and making laws of dubious constitutionality pending a Constitutional Court ruling, or secondly, to create institutions and a climate of opinion that upholds the rule of law in its full and proper sense as a national value that informs all laws and practices. The problem with leaving it to the Constitutional Court is two-fold. It means that unconstitutional laws will be enforced indefinitely, perhaps for decades. It also presents the Constitutional Court with an intolerable dilemma" it is and should be reluctant to find laws, especially those made in the new South Africa and laws that have already had far-reaching consequences, unconstitutional. It should not be under pressure to compromise the letter and the spirit of the Constitution. The constitutional watchdog function should be performed at the other end of the statutory process, when laws are being conceived – long before they are presented to ministers and the public. To this end we should consider the tendency in mature democracies to have all laws drafted by specially trained experts in a central drafting agency, and subjected to mandatory screening by an antonymous agency. This would be an ideal criterion for peer review under NEPAD.

Finally, it is necessary to respond to what has become popular rhetoric to the effect that individual aspects of the rule of law cannot be upheld absolutely. It is argued, for example, that the separation of powers has to be compromised because in a modern complex world legislators cannot be expected to take

responsibility for all the legislation required. This is nonsense. There is no reason why substantive law now being processed as regulations ("subsidiary legislation") shouldn't be presented parliament as part of the Act concerned. Indeed, it is impossible for legislators to make laws in good faith if they do not know what law they are really making because its substance will be in a subsequent regulations never considered by them.

Perhaps more profoundly, the assumption that the world is more complex or that a complex world needs more laws, is mistaken. The "modern world" is primarily in the first world. We are a developing country. The quantity and nature of laws appropriate for our state of development is that which existed in the world's most advanced countries when they were where we are now. We curtail our prospect of catching up to them to the extent that we mimic what they do after their success. Even if we were an advanced democracy, the so called modern world is not more complex. Modernity makes the world increasingly simple and enhances the ability of citizens to cope with it. The fact that they have more education, wealth, technology, civil liberties, civil society, and all the other trappings of modernity, means that their lives are simpler – they work shorter hours, have jobs that are less challenging, have more congenial working conditions, retire earlier, live longer, and have a better quality of life according to every measured index. As the eminent jurist Richard Epstein has observed, modern advanced democracies should be replacing complex laws with simple rules that create unambiguous rights and are readily understood by people to whom they apply.