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“SPECIAL ECONOMIC ZONES AT THE ERE OF THE NEW AFRICAN CONTINENTAL TRADE CONTEXT: GUIDELINES AND CHALLENGES”



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Special Economic Zones (SEZ) and the African Continental Free Trade Area (AfCFTA) : The issue at stake

- **Concern of some AfCFTA member states:**
How to address unfair competition that may emanate from goods produced in SEZs and traded under AfCFTA preferential treatment?
- **Rationale:**
Goods produced in SEZs benefit from tax and other investment incentives lowering their cost of manufacture. Therefore, such goods can be sold at a lower price than goods not manufactured in SEZs.
- **Two proposals** submitted (Burkina Faso and Tanzania) stating that **goods originating in SEZs should not be considered as originating in the context of the AfCFTA** and therefore, will not benefit from preferential tariffs unless they pay back duty reliefs and taxes.
- AfCFTA will contain “regulations on SEZ” that are currently under discussion (see 10th AMOT decision and RoO TWG of March 2020)

¹<http://www1.worldbank.org/prem/PREMNotes/premnote11.pdf>



The challenges and the impact of excluding SEZ from the AfCFTA

- 1) SEZs have evolved: many countries offer tax and investment incentives to companies / firms not in a specific enclave;
- 2) Excluding goods produced in SEZs will reduce the effectiveness and efficiency of the AfCFTA as it may exclude sizable shares of intra- African trade from the scope of ACFTA ; and
- 3) The tax incentives provided to firms in SEZs may not necessarily allow them to reduce costs of production. Unfair competition is not demonstrated.



World Bank definition of a Special Economic Zone (SEZ) and/ or Export Processing Zone (EPZ)

- An SEZ is one of many export promotion tools, including bonded warehouses and temporary admission schemes that are geared to:
 - provide a country with foreign exchange earnings by promoting non-traditional exports
 - create jobs and generate income
 - attract foreign direct investment
 - engendering technology transfer
 - knowledge spill-over
 - demonstration effects
 - backward linkages
- SEZs usually provide firms with preferences, which are granted by the government such as:
 - preferential tax or duty treatment
 - exemptions from restrictions on the repatriation of profits
 - direct subsidies and enhanced physical infrastructure
 - expedited permissions and related services.



SEZ Objectives/Benefits and sentiments in AfCFTA negotiations

- SEZs can provide a platform for developing the infrastructure and regulatory environment in a country enabling concentrated business activity in a geographically limited area.
- Today's SEZs have evolved from their original definition
 - Many firms, called export processing firms, now benefit from the incentives offered in the zones without being physically fenced in. This makes the task of determining SEZs, and identifying firms that receive benefits usually associated with SEZs, more difficult.
 - However some African Members states nurture hostile sentiments towards firms established in SEZ since they are not perceived as being truly African as they are mostly foreign owned, do not particularly benefit the local economy with backward linkages and therefore should not benefit from AfCFTA.



Treatment of SEZ in African RECs

The large majority of African RECs treats goods in SEZ as originating with the exception of ECOWAS

	Provision	Treated as originating?	Treatment of goods produced in SEZs or similar
ACP Cotonou	Protocol 1, Article 36	Yes	Granted preferential tariff treatment if Rules of Origin requirements of the Cotonou Agreement are met
COMESA	Protocol on the Rules of Origin (2015)	Yes	Granted preferential tariff treatment if requirements of the COMESA Rules of Origin are met
EAC	Protocol on the Rules of Origin (2015)	No provision	No provision
ECCAS	No provision	No provision	No provision
ECOWAS	Protocol A/P1/1/03, Article 7	No	Not granted preferential tariff treatment
SADC	No explicit provision	No explicit provision	- No explicit provision
TFTA	Tripartite FTA, Annex 4, Article 40	Yes	- Granted preferential tariff treatment if requirements of TFTA Rules of Origin are met.

Source: Derived by Authors from various sources



Treatment of SEZ in African EPAs with the EU and under the AGOA

And the same can be observed in EPA with EU....
AGOA has no explicit provisions for products originating in EPZ.

	Provision	Treated as originating ?
ACP-EU EPA (<u>Cotonou Agreement</u>)	Protocol 1, Article 36	Yes
EAC-EU EPA	No provision.	N/A
ESA-EU Interim EPA	Protocol 1, Article 40	Yes
SADC-EU EPA	Protocol 1, Article 42	Yes
West Africa-EU EPA	EPA between the EU and West African States / ECOWAS / UEMOA, Annex 2 (Protocol 1), Article 40	Yes
SACU-EFTA FTA	Annex V, Article 33	Yes



Conclusion: Almost all FTAs provides for preferential treatment to goods originating in SEZ.

- **No restrictions** applied on preferential treatment to product originating in SEZ

Most African RECs with the exception of ECOWAS

EU-EPAs with African RECs and AGOA

- **It would be detrimental to AfCFTA objectives to exclude products manufactured in SEZ from AfCFTA:**

If Limitations are introduced in AfCFTA for products originating in SEZ:

- a product manufactured in a SEZ located in AfCFTA will receive a preferential tariff treatment when exported to EU and US, while the same product will not be entitled to AfCFTA tariff treatment.
- EU SEZ could benefit preferential treatment when exporting to Africa under EPAs and AEZ could benefit preferential treatment for export to EU but not to AfCFTA partner
 - ❖ **Conclusion:** such a provision would work as a disincentive to invest in SEZ for exports to AfCFTA markets.
 - ❖ This is in exact contradiction with the AfCFTA objectives.



“Unfair trade/competition arising from products originating in SEZ” – Where is the evidence ?

- “Unfair competition/trade” - not formally defined.
- Documented studies including empirical analysis (ex. figures comparing trade costs across countries) are lacking. **The key questions** are:
 1. Do Tax Credits, Exemptions & Rate Reductions in SEZ granted to African SEZ provide **effective cost advantage on export markets** ?
 2. Does the cost advantage generate a **severe injury / damage** to a given domestic industry in the export market that can be clearly identified?
 3. Is there a **causal link** between the Tax Credits, Exemptions & Rate Reductions in SEZ and the injury?
- **Predatory pricing and unfair competition in Africa – a comment**

Presupposes the existence of an industry suffering injury

 - Do these industries exist in Africa?
 - If the industry does not exist, excluding goods originating in SEZ from the AfCFTA preferential treatment may prevent/delay the development of such industries.



Are Tax Credits, Exemptions & Rate Reductions subsidies generating cost advantages? And if so, only in SEZ?

- Companies in SEZs or companies receiving what are considered tax and investment incentives may not necessarily be any better off – in terms of cost of production – meaning that they are not a source of unfair competition.
- A tax expenditure in government budgets **may not be a tax incentive** for business.
- Ex. a tax incentive comprising capital allowances, depreciation schedules, and VAT and import tax exemptions may be regarded by the investor as the minimum expected structure of an “investment grade tax system” in relation to business expenses and treatment of losses and not an incentive.
- Tax credits, exemptions, or rate reductions can give direct benefits to a subset of taxpayers, **who may not be in a SEZ**
- They act as an incentive such as encouraging companies to invest, develop infrastructure, or set up in disadvantaged regions.
- Such tax expenditures overall are huge: estimated at 2% of GDP in Ghana and 2.5% of GDP in Kenya and Tanzania¹.

¹<https://www.cgdev.org/blog/good-bad-and-ugly-how-do-tax-incentives-impact-investment>



Can Tax credits, exemptions, or rate reductions “unfair competition” be addressed with rules of origin?

- Tax credits, exemptions, or rate reductions do not systematically provide cost advantage and; are not granted exclusively to firms located in SEZ.
→Categorising all goods produced in SEZs as non-originating sets a negative precedent and could be counter-productive and “unfair”.
- If the intention is to address unfair competition deriving from subsidized goods benefiting from an effective cost advantage, then all goods should be scrutinized not just goods originating in SEZs.
- This would practically impossible to implement.



Subsidies and Countervailing Measures as the first best option

- WTO Members are prohibited from subsidising exports and these provisions are contained in the Agreement on Subsidies and Countervailing Measures (ASCM).
- The tax rebates and other kind of tax incentives granted to industries and firms located in SEZ may be considered as subsidies that may be prohibited or actionable.
- **Recommendation**
If AfCFTA members states are concerned about unfair competition from subsidized goods, whenever produced in SEZs or elsewhere, then it is more appropriate to address this “unfair” competition with purpose-built instruments such as the WTO agreement on subsidies and countervailing measures or inspired by it.
- Economic rationale: **targeting principle.**
Unlike the trade policy instruments contained in the ASCM, Rules of origin are not specifically designed to address unfair competition problems.
Horizontal measures are not appropriate to address a specific problem
A second best approach should be applied only when no first best option is available.



The role of the WTO ASCM in addressing potential “unfair trade” practices

- Since most AU Members are also WTO Members, or aspiring to be WTO Members, the WTO ASCM is the appropriate basis providing the legal trade remedies available to AfCFTA State Parties to address any unfair advantage that may be conferred by subsidies in form of tax holidays, rebates and incentives to firms located in SEZs.
- Article 2 of AfCFTA Annex 9 on Trade Remedies makes explicit reference to the WTO ASCM. Such provision may eventually be amplified to reflect such concern.
- It may be further considered and studied how other FTAs have dealt with the WTO ASCM to reflect similar concerns.
- Provisions about State aids could be discussed in AfCFTA in the appropriate context .



Conclusions / Recommendations

Products originating in SEZ should be granted AfCFTA preferential treatment according to the original AfCFTA text

Issues related to unfair trade competition arising from subsidies granted to SEZs should be addressed using the WTO ASCM and the available provisions in AfCFTA Annex 9 on Trade Remedies.

It is of vital importance that the “*regulations on SEZ*” to be discussed in AfCFTA negotiations are circulated to stakeholders

Strong advocacy actions are crucially needed:

Stakeholders and the AEZO, as an association, should make their views known to the African Union by strong advocacy actions including the drafting a position paper

SEZ should advocate their case to the national authorities in charge of trade negotiations (Ministry of Commerce) to get their view represented in Trade negotiating forum .



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