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SPECIAL ECONOMIC ZONES - WHITE PAPER

POLICY CONSIDERATIONS FOR THE GOVERNMENT OF ETHIOPIA

SEZ DIAGNOSTICS AND LEGAL DRAFTING TASKFORCE

ETHIOPIAN INVESTMENT COMMISSION

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SPECIAL ECONOMIC ZONES WHITE PAPER: POLICY CONSIDERATIONS FOR ETHIOPIA

1. INTRODUCTION AND OBJECTIVES

Today used by more than 140 economies around the world, Special Economic Zones (SEZs) have become a global phenomenon and integral part of the global supply and value chains within just fifty years. Challenged by rising global competitive pressure to attract mobile industrial activity and growing importance of global value chains, many developing economies and almost all transition economies worldwide have turned to SEZs as a tool to encourage innovation, productivity and economic growth.

Special Economic Zones are defined as geographically delimited areas within which governments facilitate industrial activity through **fiscal and regulatory incentives** and **infrastructure support.** Their common feature is that within a defined perimeter, they provide a regulatory regime for businesses and investors that is **distinct from what normally applies in the broader national or sub-national economy** where they are established (UNCTAD 2019).

Over the last decade, Ethiopia has experimented with a narrowly defined constituent of SEZs - through the planning and operation of industrial parks (IPs) - by providing them relief from tariffs and administrative burden of the bureaucracy and customs procedures. Like most other economies, the Government of Ethiopia (GoE) aimed - through its IPs - to attract FDI, create jobs, enhance export performance, grow industries, and generate sustainable growth.[1]

However, the Ethiopian IP regime has had several limitations - including the fact that it is too narrowly defined and restrictively focused.

When looking at developing a SEZ policy framework, it is important to begin from stock taking - through which the economic and comparative advantage of a country is analyzed, target sectors are identified, and related growth constraints are examined.

This **SEZ White Paper for Policy Consideration by the Government of Ethiopia** is developed to articulate clearer policy options and considerations for the GoE. It reviews:

- global best practices and country experiences;
- draws on lessons learned;
- cross-references to national experiences and opportunities, and
- offers specific recommendations that should be adopted in Ethiopia - based on international best practices in SEZ development, operation and management.

Substantively, the **SEZ White Paper for Policy Consideration by the GoE** defines:

- the objectives for development of SEZs in the Ethiopian context;

[1] Industrial Park Proclamation No.886/2015. Preamble.

- the classification of zones and sub-zones operating within a broader SEZ;
- key regulatory instruments applied across SEZs;
- SEZ governance models;
- investor entry and establishment requirements;
- the regime of incentives, and
- the role and administration of customs services.

2. FROM INDUSTRIAL PARKS TO SEZS: RATIONALE

The significance and policy objectives of SEZs differ substantially among economies at different levels of development (UNCTAD. 2019c). As is the case in most developing countries, the key driving factors in Ethiopia could be organized around six aspirations: FDI attraction, trade promotion, job creation, export growth, integration into value chains, and economic diversification.

Yet, even where a convincing socioeconomic logic exists, the success of a SEZ policy regime is a coefficient of three key factors, namely strategic focus, regulatory and governance models, and the effectiveness of investment promotion and facilitation tools (UNCTAD 2019). Ethiopia's initiative should strive to avoid common pitfalls which many economies had faced.

Apart from the policy objective considerations, the immediate call for a comprehensive SEZ policy and legal framework in Ethiopia is also underpinned by several reasons and potential benefits. The most important ones are presented as follows.

A) A restrictive industrial parks legal regime

The first reason for the adoption of a SEZ regime emanates from recognition that the industrial parks (IP) policy and legal framework in Ethiopia has been **unnecessarily restrictive - with its singular focus on 'priority manufacturing industries'.**

Ethiopia's IP regime has been at the core of the country's strategy to transform the manufacturing sector and is often credited for playing a key role in this success story.[2] With the establishment of the first industrial zone in 2007,[3] IPs have been a part of the Ethiopian economic landscape for over a decade. However, it was only in 2014 that the GoE launched a focused IP policy, which was followed by a proclamation in 2015 and a regulation in 2017. The number of IPs has now reached 18 (13 public and 5 privately owned and operated).

A recent review of IPs in Ethiopia carried out by the World Bank (the Review) found that IPs have **directly created 90,000 jobs and contributed to the country's export earnings,** with the share of IPs in all manufacturing exports accounting for 40% in 2019/20, up from just 11% five years earlier.[4] The Review also found that despite the success in some key areas

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[2] UNCTAD. 2021. Handbook on Special Economic Zones in Africa.
[3] The first Industrial Park was the Eastern Industrial Park - developed by a Chinese private investor.
[4] World Bank. 2022. On the path to industrialization: Review of Industrial Parks in Ethiopia.

like employment, IPs have **not yet reached the scale to demonstrate a macroeconomic impact or meaningful backward and forward linkages**.

In addition, the Review also looked at the design and implementation of the IP program, and highlighted the following key areas (gaps) of the legal framework as needing reform:

- widening its focus on other types of productive activity beyond narrowly defined scope;
- further clarifying institutional responsibilities as it contains overlaps and duplications concerning regulatory and operational functions between the Ethiopian Investment Board (EIB), Ethiopian Investment Commission (EIC), the Industrial Parks Development Corporation (IPDC) and Ministry of Industry (MoI); and
- streamlining and integrating the legal and institutional framework for IPs led by the federal government and states.

A comprehensive SEZ policy is required to provide an opportunity to fill gaps that exist in the current IP laws which limited the types of investment activities covered. International good practice informs that any SEZ law should allow the broadest possible range of activities - which was not the case in Ethiopia.[5] A SEZ policy enables Ethiopia to cater its comparative advantages and policy priorities, while at the same time allowing sufficient flexibility to accommodate a wide range of sectors and investments.[6] This is consistent with best practice where most SEZs operate as multi-activity zones - while bearing in mind that countries at different stages of industrialization show a clear SEZ development ladder or specialization.[7] In Africa, several countries have updated their SEZ-linked legislation to respond to changing considerations and priorities and supplement already existing regimes.

To this is also added a related factor - that **several SEZ-linked investment interests that go beyond the manufacturing sector - are already tabled** to the regulatory agencies in Ethiopia.

B) SEZ as a platform for national policy experimentation

The experience of economies that have successfully achieved rapid industrial development through SEZs shows that zones are best used not just as an **investment promotion tool**, but mainly as **industrial policy tool**. By design or implementation, SEZs in many East and South-East Asian economies have focused on stimulating wide-scale economic growth by using them as platforms for experimenting efficient and conducive investment and business environment reforms. Indeed, in China, the policy decision for moving towards SEZs was aligned with broader economic reform process; as such SEZs were used as policy instruments for:

- testing the ground for new or more liberal foreign economic policies and laws;
- creating managed opening or windows for advanced technology and skills transfer from the developed world, and

[5] Ibid.
[6] Ibid.
[7] UNCTAD. World Investment Report. 2019. Special Economic Zones.

- advancing a political economy agenda towards Hong Kong and Taiwan.

In Ethiopia where a less liberal economic and trade system prevails, **establishing a SEZ policy regime would be highly recommended to pilot several economic reforms** by offering tax and tariff incentives, fiscal supports, streamlined customs procedures, and reduced regulations. SEZs will serve as localized reform bases for strategic decision made by the GoE **to understand and gradually prepare the rest of the economy** assume greater role in global market share and diversify its scope of engagements.

C) Accelerate trade liberalization

With the entry into force of the African Continental Free Trade Area (AfCFTA) and negotiations ongoing for Ethiopia's accession to the COMESA FTA, trade liberalization is no longer optional but a mandatory undertaking for Ethiopia. The liberalization in Ethiopia is still lagging behind many of its neighbors and economic peers. SEZs, and more specifically, policies pursued on the establishment of Free Trade Zones (FTZ) **can serve as vital tools to ease the country's move towards trade liberalization** in compliance with its treaty commitments.

D) Enhance capacity to effectively compete in regional import trade

Studies showcase that import to Ethiopia from neighboring countries is significantly increasing. While Ethiopia encourages intra-regional trade among neighbouring countries, it also needs to establish its own zones that can compete on efficiency, lead time and cost by introducing a more liberalized SEZ/FTZ regime and offering facilitated investment and trade services. SEZ schemes offer the opportunity for the development of integrated infrastructure facilities that expedite the efficient establishment and operation of investments and apply targeted regulatory regimes.

Over the years, Ethiopia total import has shown major increase and is expected to double within a decade; unfortunately, this will continue to be attended by avoidable costs, lead time margins and inflation effects which could have been circumvented or minimized. This highlights the need for the deployment of SEZ/FTZ schemes that are attended by efficient and modern logistics services and import distribution networks - a classic service portfolio that is catered by SEZs.

Indeed, best practice informs that SEZs can be instrumental in the development of GVCs and as policy tools that boost countries' participation in GVCs. Trade costs such as tariffs, transportation, insurance, border taxes and fees accumulate when intermediate goods are imported, processed and then re-exported downstream in complex GVCs across different countries. **By lowering such transaction costs within GVCs, SEZs contribute to the profitability of national operations**.[8]

[8] Ibid.

This insight for establishing a national SEZ program draws a parallel from early experiences of mainland China where its economy and trade was negatively affected by Hong Kong's liberalized trade scheme - which prompted China to develop a successfully competing Free Trade Zones program. In practice, it is not uncommon for individual countries to follow the example of early adopters of successful SEZ programs and compete with them within the same regions.

This rational is also in reading with the GoE's decision to implement the national logistics strategy. The strategy aims to fundamentally reform the logistics sector in order to, among others, ensure economic efficiency of the import trade scheme and sustainably guarantee the provision of critical inputs to the manufacturing sector - a sector that continues to face serious constraints to date and gravely under-performs due to shortage of industrial inputs.

POLICY RECOMMENDATIONS

The fore-stated factors justify that:

- the GoE **recognize the SEZ program** as one of its national economic policy instruments that propel socioeconomic growth and associated objectives, and
- to such end **endorse a clear policy framework** that directs specific roles and regulation of SEZs.

3. SCOPE OF APPLICATION OF SEZ POLICY/LAW

3.1. GENERAL

Clarity on the substantive scope of application of any SEZ policy or legal framework - including SEZ subsets - is extremely vital. This has direct correlation with the designation, incentives and regulatory approaches adopted.

Conventionally, the concept of SEZ has been defined expansively to embrace or alternatively signify a number of sub-sets. For instance, Ethiopia's Industrial Park law chose to define 'industrial parks' as including SEZs, Free Trade Zones (FTZ), Technology Parks (TP), Export Processing Zones (EPZ), Agro-processing Zones and other similar investments.[9]

Likewise, UNCTAD, World Customs Organization, the World Bank, and the World Free Zone Organization offered various definitions by just focusing on certain core features - that, in many instances also used SEZ and FTZs interchangeably. While bearing in mind the significance of the various nomenclatures from regulatory points of view, generally the core features of SEZs include:

- geographical delimitation (in some cases fenced);
- designation issued by a government;

[9] While EIB is vested with powers to designate any such zones as 'Special Parks' focusing on specialized field or as FTZ or EPZ in which goods may be landed, handled, manufactured or reconfigured, and re-exported or supplied as input for industrial parks, **Ethiopia does not have comprehensive regulation** that can attend to the needs of the various sub-sets - the focus of the IP law being on operations of the manufacturing sector.

- application of fiscal and regulatory incentives that are different from the wider economy;
- economic activities, whether production, logistics or trade, physical or virtual with respect to goods, services or both, are permitted/carried out, and
- provision of infrastructure support;

POLICY RECOMMENDATIONS

In this light, the key policy recommendation is that in reading with global best practice, a policy framework that considers **SEZ as embracing IPs/EPZ, FTZ, LPs, and with some conditionality, Science and Technology Parks (STPs), Service Parks (SPs), Agriculture Zones (AZs), and Livestock Zones (LZs) - should be adopted.** Hence, under the SEZ policy/legal framework:

a) the concept of SEZ as a domain of regulation **should be conceived (and organized) as extending to any geographical area** fulfilling the fore-stated minimum parameters and **covering all investments** carried out within SEZs in Ethiopia - without any sectoral exclusion;
b) the common term 'SEZ' should be used as a generic word covering **all varieties and sizes of zones** - including IPs/EPZ, FTZ, LPs, STPs, Service Parks, AZs, and LPs;
c) key regulatory matters **that capture the unique feature of each SEZ constituent must be organized** - since not all SEZ varieties/sub-sets are amenable to the same designation, facilitation or even regulatory approaches.

3.2. CONVENTIONAL SEZS: IPS/EPZ, FTZ, LOGISTICS PARKS

A) INDUSTRY PARKS/EXPORT PROCESSING ZONES (IPS/EPZS)

The concept of SEZ as extending to 'industrial parks' or 'export processing zones'[10] primarily involves manufacturing and processing zones in which:

- general or focused industrial activities are undertaken (e.g., textile, apparel, agro-processing, pharmaceuticals, metalworking, automotive, electronics etc.) for export or domestic markets, or
- goods are handled, manufactured or reconfigured and re-exported to external markets.

In relation to IP activities, nearly all publicly-owned parks follow the clustering approach - where parks are required to attract only investments specializing in certain sectors (mostly textile and garment).

[10] EPZs first appeared in the 1950 and 60s as means of promoting industrialization in developing countries; they are fenced-in industrial estates which, like FTZs, lie outside of a host country's customs territory. Traditionally, investment in EPZ were restricted to FDI and manufacturing for exports markets, but they have significantly evolved since the 90s' to open to wider industries and apply relaxed export requirements.
UNCTAD. World Investment Report. 2019.

In principle, sector-specific SEZs do present advantages in terms of cross-company collaboration and resource and facility sharing. Firms belonging to the same industry and located in the same zones benefit from knowledge spillovers and economies of scale which enable them to reach greater productivity through improved production processes.[11] Moreover, specialized zones tend to be characterized by higher GVC participation and growth rates.[12] Since countries tend to adopt specific types of SEZs based on stages of economic development, industry-specialized zones are more common in transition economies - while innovation/technology-driven zones are most common in advanced and emerging markets in Asia.[13]

Over the years, Ethiopia has espoused a de-facto policy of clustering. This has engendered limitation on growth of the manufacturing and other investment sectors. While specialization presents advantages, it is known that its full potentials could be reaped only over a longer period of time. Further, a sectoral focus may not be required in some instances, for example if the SEZ is supposed to merely serve as entry point into regional markets in which case investors from different industries benefit from setting up shops within a zone without sectoral logic.[14]

Statistically too, the vast majority of African SEZs (89%) are multi-activity zones, hence not focusing on a specific sector but rather hosting a variety of industrial activities.[15]

Going forward, it is recommended that SEZs/IPs should be given the discretion of organizing their activities as **'multi-activity parks'** (focusing on general industrial development regulated through a zoning system) or **'specialized parks'** (focusing on sector or industries or global value chain activities such as business process outsourcing, call centers, research and development centers etc.). **In this light, the current practice of 'clustering' de-facto imposed on park investments needs to be revised through policy review** - without prejudice to establishing the powers of a regulatory body to require, where appropriate, the designation of some parks as 'specializing' in very specific sectors or industrial activities.

B) FREE TRADE ZONES

The oldest and most common form of SEZ, Free Trade Zones (also called commercial free zones or foreign trade zones) - are fenced-in, duty-free areas. They mainly offer trade related services such as warehousing, sales, exhibition, storage, and distribution facilities for

[11] Thomas Farole & Deborah Winkler. 2014. Making Foreign Direct Investment Work for Sub-Saharan Africa: Local Spillovers and Competitiveness in Global Value Chains. World Bank.

[12] UNCTAD. World Investment Report. 2019.

[13] Ibid.

[14] This was, for instance, the case of early zone development in the Taiwan Province of China (1966), Singapore (1969), and the Republic of Korea (1970); they were established as multi-activity, labor-intensive and export-oriented EPZs - later converted to specialized zones targeting high-tech industries (such as biotechnology and software).
Ibid. Also in: UNCTAD. 2021. Handbook on Special Economic Zones in Africa.

[15] UNCTAD. World Investment Report. 2019.

trade, trans-shipment and re-export. They also host light operations such as packaging, labeling, quality control, and sorting. FTZs are usually small areas - segregated and operating without the intervention of customs authorities.

C) LOGISTICS PARKS/HUBS

Ordinarily an aspect of FTZs, Logistics Parks/Hubs (LP) refer to areas within (or adjacent to) a SEZ or FTZ where commercial, warehousing and logistics services are rendered, and/or trade facilitation and management services for trans-shipping, distribution and re-exports at sea-ports, airports or borders are conducted in the service of enterprises.

Often, companies operating within LPs also use such hubs to assemble, package, process or do light manufacturing of products.[16] Companies can use LPs to operate and serve local markets, regional markets, or international markets.

While most logistics hubs are established alongside sea borders, the development of inland hubs (inland container terminals - ICTs or dry ports) has also seen significant expansion in recent years. LPs first appeared in Tokyo, Japan, and then developed in Germany, The Netherlands, the United States and other developed countries.

Since the conceptualization of 'logistics sector' raises serious policy implications in relation to sector opening, incentives, licensing and regulation, it is important to carefully outline and understand the business lines which a logistics investment entails.

There are various levels of divisions and frameworks of understanding their functional framework (type of services provided within LPs) and organizational framework (type of logistics hubs considered).

First, from a **functional point of view**, logistics hubs may provide various types of services indicatively included in the table below.

LOGISTICS SERVICES	BUSINESS AND COMMERCIAL FACILITIES	COMMON FACILITIES
- cargo aggregation, segregation - sorting, grading, packaging, repackaging, tagging, labeling - consumer, trade, product sales, distribution - inter-modal transfer of material, container - open and closed storage - ambient condition storage for transit period - custom-bonded warehouse - material handling equipment, facilities for movement and distribution of semi-finished or finished products	- dormitories, - guest houses - canteen - medical center - petrol pump - banking and finance - office space - hotel - restaurants - hospital/dispensary	- weigh bridge - skill development center - computer center - subcontract exchange - container freight station - container terminal - production inspection center

[16] Agility Logistics Parks. November 2021.

- integrated supply chain (purchasing, supply, inventory management, material planning, distribution, capacity management)	- administration office	

Second, from **operational point of view**, logistics may constitute facilities ranging from basic or standalone to more complex multi-user facilities. Standalone facilities like a warehouse or an ICD may be operated by a single logistics service provider for a specified type of product or a client. On the other hand, the facilities may be of a multi-user type where multiple logistics service providers operate and serve multiple and various customers.

The simplicity and complexity of the facilities also depend on the types of equipment employed and volume of cargo handled. The main types of facilities and structures include the **inland container terminal/depot, a bulk terminal, a consolidation center, and a distribution center.**

In general, the above types of services may exist *separately* or as *integrated logistics hub*. Integrated service logistics parks usually have more than two modes of transportation which can realize multi-modal transport and seamless connection; they can provide at least two or more of the services indicated above, and meet the scale logistics needs of cities and regions.

POLICY RECOMMENDATION IN RELATION TO IPs/EPZs, FTZs, LPs

Key SEZ policy issues that are of interest to the proper functioning of IPs/EPZs, FTZs and LPs are cross-cutting; they entail policy interventions on sector opening, access to finance/forex, incentives, customs facilitation, and regulation. Each of the topics is addressed separately - in the subsequent sections.

3.3. NON-CONVENTIONAL SEZ: SCIENCE AND TECHNOLOGY PARKS (STP), SERVICE PARKS (SP), AGRICULTURE ZONES (AZ), AND LIVESTOCK ZONES (LZ), WIDE-AREA PARKS

Science and Technology Parks (STP), Service Parks (SPs), Agricultural Zones, Livestock Zones, and Wide-Area Parks are labeled as 'non-conventional' varieties of SEZs solely for purposes of this document - because of the extreme diversity of activities undertaken under the banner of such parks and unique designation and regulatory approaches potentially required in respect of such entities.

A) SCIENCE AND TECHNOLOGY ZONES

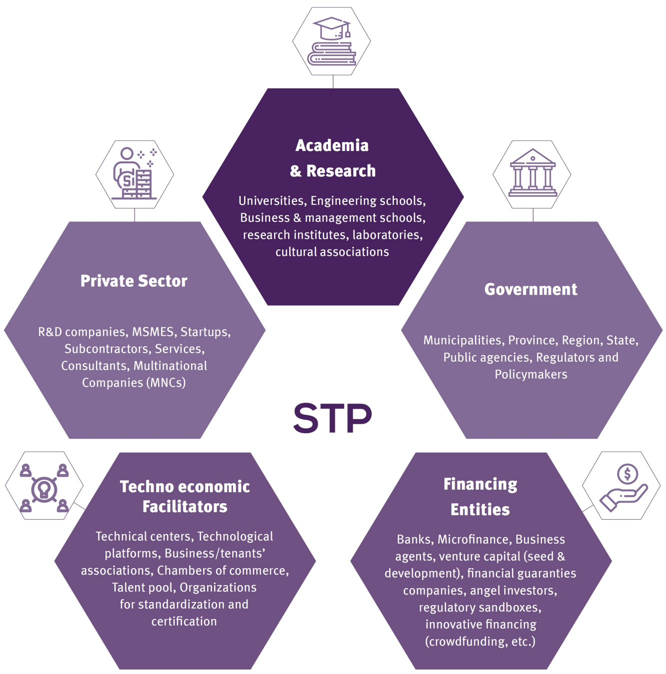
Like SEZs, Science and Technology Parks come under different nomenclatures. They can be labeled as a subset of the larger definition of SEZs. They focus on **commercialization of research and incubation of start-ups, and promotion of innovation culture and competitiveness of business and knowledge-based** institutions. Their activities are distinct from industrial areas called 'high-tech zones' which focus **on scaled-up manufacturing** in highly technology-intensive and R&D industries.[17]

Most science parks are not SEZs, technically speaking, as they tend to lack a distinct regulatory framework. Conversely, not all SEZs that focus on science, technology and innovation qualify as science parks since they may not have recognizable links to knowledge-based institutions (e.g. universities).[18]

The first known STP - the Stanford Industrial Park was established in the 1950's in the US Silicon Valley. Over the next decades, various types of parks emerged globally; these include research parks, innovation parks and business incubators. The diversity of their functions and nature has allowed them to be used in various countries globally.

In Ethiopia, STPs can be used to promote **the next stage of development** of industrial parks, specialized trade zones and export processing zones. By 2017 alone, more than 6000 STPs were operating worldwide. However, only 25 percent of the STPs, mostly in advanced economies, are held to be successful in achieving their goals.

- **Government:** creates policy and regulatory framework favorable for the establishment of STPs; often provides the main initial investment.
- **Academia & Research:** provide R&D experience, research methodologies, skilled workers, as well as access to expensive testing and research equipment.
- **Private Sector:** represents the link to market and allows the development and commercialization of innovative and technology-enabled solutions, products, and business models.
- **Financing Entities:** invest in projects developed within STP, including through impact investment which, alongside a financial return, generates positive and measurable social and environmental impact.
- **Techno-economic facilitators:** provide several services including



[17] UNCTAD. World Investment Report. 2019.
[18] Ibid.

market-reach.	

POLICY RECOMMENDATIONS

First, the scope of application of the proposed SEZ policy and legal framework **should encompass STPs.**

However, the designation, administration and regulatory conditions of STPs must be structured by taking in to consideration mixed criteria which looks into such entities **as SEZs, on the one hand, and science and technology innovation hubs, on the other - where ministries responsible for education, research and innovation play critical role.**[19]

Second, from regulatory point of view, while STPs benefit from certain unique policies and incentives (in the form of exemptions from customs, fiscal or other regulatory obligations), there is no major distinction between such clustered territories and the rest of the economy. As acknowledged by UNCTAD, 'most science parks are not SEZs (in the proper sense of the word), as they tend to lack a distinct regulatory framework'.

In fact, most STPs are developed in an enclosed environment - although such measures are not intended for purposes of customs or other regulatory measures that require controlled enclosures. The objective of geographical crowding is simply to reap the benefits of having such firms, operators, higher education institutions, and other entities in a clustered environment.

In this light, **customs services and other regulatory functions should be organized with due recognition of their unique feature.**

Third, the development, operation and management of STPs is **largely government-driven**. For instance, in China, the Ministry of Science and Technology (MoST) deals with STP planning, development, promotion and implementation - by providing policy guidance and financial support.

In Ethiopia, the timing for the establishment of STPs fits into national industrial, science, technology and innovation policies and the country's stage of economic development. In this light, the SEZ policy should **establish a direction which identifies the critical role played by the GoE and national research/innovation institutes, commits initial government financial support to RD**, **and highlights the need for the establishment of such parks on a step by step basis,**

[19] For instance, in Kenya, specific provision for designation of STP has been included under the National Science, Technology and Innovation Act No.28 of 2013; since the parks are developed through the initiative of higher education institutions, the same institution is mandated to oversee all activities in the park - including bringing international companies to invest in the park and guiding students in university to come up with innovations.
On the other hand, in Egypt, the designation and regulation of such parks is specified under the Law on Special Economic Zones No.83 of 2002 and the Investment Law No.72 of 2017 - which provided for specific provisions on 'technology zones'.

B) SERVICE PARKS

In addition to more conventional industrial zones, SEZs may also be set-up with concentration on specific services (non-manufacturing sectors). The most typical of such SEZs are logistics hubs and free trade zones - which are addressed above. The less mainstream but growing service hubs come in the form of specialized health, education, tourism, business services centers, convention/conference zones and related services.

The development of Dubai Healthcare City (DFCC) is a popular example of specialized service hubs.[20] Various countries have also created SEZs to promote tourism or tourism-related industries: examples include Bangladesh, China, Indonesia, Lao, Malaysia and the Russian Federation. In countries such as the Republic of Korea, tourism is allowed in combination with other activities (e.g. in zones catering to health tourism). Tourism SEZs offer similar advantages as SEZs in manufacturing: customs reduction on capital goods, tax benefits, infrastructure support and facilitation of business registration.[21]

POLICY RECOMMENDATIONS

First, the scope of application of the proposed SEZ policy and legal framework **should encompass Service Parks.**

Since the government's objective in developing specialized service parks is mainly guided **by the need for promoting clustering effect among services providers,** the designation and administration of SPs must be structured by looking at such entities **as aspects of SEZs in respect of which special regulatory framework** that is different from the rest of the economy applies.

Second and somewhat linked to the first, because of the inherent nature of the services, **SPs should not be required to be contained in a 'designated fenced area'** that separates a zone from the rest of the economy. For example, while UAE regulates various trade, manufacturing and logistics free zones as 'designated zones', the same is not applicable to SPs like the Dubai Health Care City/Free Zone.

[20] Governed by Dubai Healthcare City Authority, the DHCC free zone is established in 2002; it brings together core healthcare services, and attracts best-in-class global and regional names and network of businesses from hospitality to consultancies and retail outlets. Currently, it is home to 120 medical facilities - including hospitals, more than 120 outpatient medical centers, as well as diagnostic laboratories with more than 4,000 licensed professionals. The Authority provides enabling ecosystem that facilitates business set-up.

[21] However, given the characteristics of tourism (mostly bound to certain locations of natural beauty or cultural value), most countries do not consider SEZ a policy tool to promote the industry - relying instead on general incentive schemes for the development of remote or underdeveloped areas, or other clustering techniques.
UNCTAD. World Investment Report. 2019.

Third, to the extent that a park-linked clustering approach is deemed to promote investment, specially designed support should be extended to SPs including, for example, access to leased lands, FDI participation, facilitated regulation, and fiscal incentives (all of which are separately discussed in the subsequent sections).

C) WIDE-AREA SEZS (WA-SEZ)

The concept of Wide Area Zones (WA-SEZ) involves the establishment of 'large and integrated zones - often coinciding with a sub-national administrative region or as townships with residential areas and amenities'. In addition to the various sub-sets of SEZs established in specific and territorially designated areas, countries may choose to establish large/wide-area SEZs.

This approach is mainly introduced for purposes of piloting broader economic and investment policy reforms in specific locations. It is widely employed by China - where, as part of its economic reforms and opening up policy, China established between 1978 and 1987 the first four SEZs in coastal areas - Shantou, Shenzhen and Zhuhai (in the Guangdong Province) and Xiamen (in Fujian Province) - all close to Hong Kong, China, Macao China, and Taiwan Province of China.[22]

The implementation of this scheme broadens the spatial dimensions of zones from relatively smaller and fenced industrial areas, and furthermore pulls the location of SEZs into the hinterland of host economies - from locations around ports. It also helps to promote the development of parts of an economy that re affected by underdevelopment.

POLICY RECOMMENDATION

While the logic of WA-SEZ appeals both in the context of piloting economic reforms and/or ensuring equitable socioeconomic development of regions, its implementation is very complex, administratively cumbersome, and entails serious political economy thinking and interventions.

In this light**, it is recommended that the scope of application of the proposed SEZ policy and legal framework should not encompass WA-SEZs**. In the interim, the very objectives which WA-SEZ meets can be realized through the deployment of a carefully designed SEZ policy and legal framework that guides the implementation of IPs/EPZs, FTZs, LPs, STPs, and SPs.

[22] The number increased in 1980s and 1990s to include large number of towns and regions along the east coast to fully leverage geographical advantages. In the early 1990s and 2000s, the geographical focus of new SEZs shifted inland and to west of China to promote regional development.
The 2018 official Zone Directory records five categories of 552 State-level zones and 1,991 provincial zones, together accounting for over half of all SEZs in the world. This total excludes SEZs established at local levels.
UNCTAD. World Investment Report. 2019.

3.4. HARMONIZATION OF INDUSTRIAL PARKS LAW AND THE NEW SEZ POLICY REGIME

Very often, a separate legal and institutional arrangement is required for the establishment, development, operation, management, and regulation of SEZs. As Ethiopia moves in the formulation of a wider policy on SEZs - of which IPs are a sub-set, it becomes imperative to decide on the **future of the existing IP legal regime** and the issue of **how best policy and normative harmonization** could be achieved between the two legal regimes.

Ethiopia's IP policy and legal regime is fundamentally structured around the IP Proclamation No.886/2015, IP Regulation 417/2017, EIB Directive 06/2017, EIB Directive 07/2020, and a myriad of Investment Board Decisions that have regulatory embodiment. Over the last seven years, also, the administration of industrial parks has evolved in to a unique institutional practice - focusing on operations, management, administration and facilitation of services to eighteen industrial parks across the country.

Going forward, the government would have to **adopt a decision on one of two options** in a bid to ensure policy and legislative harmony - each of which has its merits and demerits.

Option one is to leave the current IP normative frameworks intact - with the new SEZ policy focusing on mending policy and regulatory gaps and instituting detailed regimes relevant for the regulation and administration of EPZ, FTZ, LP, STP, SP and relatable investments. This has the advantage of maintaining the status quo which benefits from detailed normative guidance. However, the approach also risks legislative dispersion wherein the governance of conceptually the same subject matters is pursued through two distinct regimes.

Option two is to adopt only one national SEZ law which subsumes all existing developments so far. The advantage of this approach is that the regulation of all SEZ sub-sets falls under one comprehensive regime that is much easier to access or understand. The disadvantage is that incorporating critical elements of the IP proclamation and IP regulation into the new SEZ legal framework will inevitably render the SEZ law a bulky document.

POLICY RECOMMENDATIONS

- considering that there is a possibility of mitigating the drawbacks of adopting one comprehensive SEZ law, **it is recommended that the government espouses Option Two;**
- substantively, such law **must embody two critical features**: one aspect covering general principles and rules that cuts across all forms of SEZs (horizontal), and a second aspect providing for the possibility of specialized and/or detailed regulation of specific types/category of SEZs (vertical).
- again, while all investments deserving SEZ designation would be screened rigorously for compliance with minimum set of objective standards, **a clear policy direction must also be offered in terms limiting SEZ designations to geographical areas that are priorly identified by the GoE in reading with its development plans;**

4. FINANCING THE DEVELOPMENT OF SEZS

SEZs require huge financing for **on-site infrastructure** - including power, utilities, internal roads, common facilities and buildings, as well as for **off-site infrastructure** - such as access roads and utility connections. SEZs also require financing availed to private firms investing within them and to cater for expenses related to zone management and operations.[23]

Financing off-site infrastructure is a major investment; it involves coordination with public policy and broader national infrastructure planning. Typically, off-site infrastructure investment is funded by public sources or through public-private partnerships (PPPs).

In contrast, the financing of on-site infrastructure and management and operation within SEZs is carried out through mixed models which include public financing, PPPs, and private financing.

The main sources of finance for SEZs development are private equity, multilateral development banks (providing finance for technical advice) and international financial institutions (providing finance of early-stage projects).[24]

POLICY RECOMMENDATIONS

The following financing models are recommended as informing Ethiopia's SEZ policy - the main objective being **SEZs should not grapple with upfront costs required for their development and operations.** Further, the appropriate rules on access to finance would have to be structured based on such considerations.

a) **Off-site infrastructure development** in SEZs should be financed through public or PPP models; major sources of finance include national/regional governments, international development associations, regional banks, and commercial banks.
b) **On-site infrastructure development** may be owned by public, private or PPP models; major sources of finance could be self-financing, international financial corporations, venture capital, regional banks, and partner countries.
c) SEZs may be owned by public, private or PPP models; major sources of operation and management finance include self-financing, international financial corporations, venture capital, regional banks, and development partner countries.

5. SEZS' REGULATORY REGIME: CENTRALIZATION *vs* DECENTRALIZATION IN SEZ POLICY-MAKING POWERS

5.1. INTRODUCTION

SEZ policies around the world differ considerably depending on the countries' specific industrial structures, current development stages and growth opportunities. However, they

[23] Judith E. Tyson. 2018. Financing Special Economic Zones: Different models of financing and public policy support.
[24] Ibid.

all involve a **special regulatory regime** (which may be enacted at different levels of governance) and **separate institutional set-up.**[25]

Substantively 'SEZ Laws' cover various matters; they define the scope and objective of SEZs, the powers, responsibilities, rights and obligations of regulatory agencies, developers, operators, enterprises and other end-users, institute incentives offered to developers and various end-users, outline the entry/establishment requirements, and address issues of access to land, taxation, employment conditions, and environmental matters.

Specific rules that are of interest to SEZs may be contained under a country's general regulatory framework and/or in SEZ-specific legislation. Detailed trade rules, tariff systems, administrative procedures, specific customs procedures etc. are indicated in separate but dedicated legislation. The point is national experiences regarding the manner in which a SEZ special regime and the general legislation interact and the degrees to which SEZ rules differ from the general legal framework vary considerably.

From the point of view of sources of legislation, the level of centralization and decentralization in SEZ policy and law-making powers is a subject of greater importance for some countries - mainly those with a federal state structure. In some states, a decentralized policy-making in the establishment and development of SEZs has led to excessive competition between provinces and misuse of resources and land.[26]

In this light, the questions of:

- which tier of governance **should be vested with SEZ policy making powers**;
- **what the nature of the interaction** between SEZ-specific and the general laws should be like, and
- what roles are played **by local governance structures in the context of SEZ law-making and execution** must be addressed clearly in any SEZ policy framework.

This is more important in Ethiopia where the federal and state governments are granted various powers of law-making on diverse subjects; the SEZ policy's approach is critical to avoid unhealthy competition between and among regions and city administrations.

The global practice is overwhelmingly **in favor of according central governments an exclusive power of making SEZ policy and legislation**, with little or no space afforded to local governance units.

5.2. THE CURRENT APPROACH IN ETHIOPIA

Ethiopia's current IP policy and legal frameworks are consistent with the centralization approach. The IP regime is instituted through a legislation adopted by the federal parliament. Article 3 of the IP Proclamation stipulated that its provisions 'shall, uniformly in the territory of Ethiopia, apply to the federal industrial park activities or activities

[25] UNTAD. World Investment Report. 2019.
[26] OECD. 2018. OECD Investment Policy Reviews: Cambodia.

undertaken in connection with them - as well as to any person conducting any activity in the federal industrial park'. Substantively, they leave little or no room for regional policy-making and governance.

More specifically, Article 22 of the Proclamation established specific modalities for the acquisition and transfer of movable and immovable assets within industry parks, and the in-applicability of urban and rural land tenure and use systems (including leases, sub-leases, registration, site developments, construction etc.). Further, Article 23 on building norms specified that notwithstanding the provisions of any other laws, the pertinent norms or standards in respect of the development of industrial park land, infrastructure and the construction of industrial park building and structures shall be specified by the IP regulation.

From IPs regulatory administration point of view, the laws also vested a near-complete jurisdictional monopoly in the hands of the EIB and EIC.

The effect is that only federal IP law defines specific rights, obligations and regulatory regime that apply on all aspects of industry park operation.

5.3. OTHER COUNTRIES' EXPERIENCE

In **Philippines**, the SEZ Act No.7916 (1995) was ordained by Congress; the law declared the Philippines Economic Zone Authority (PEZA) as the sole regulator. Designation is effected via presidential proclamation on the basis of a recommendation by PESZA and in coordination with municipal and national/regional land use committee.

In **Kenya**, the SEZ ACT No.16 (2015) was adopted by Parliament;[27] SEZs are established by declaration of the Cabinet Secretary - based on recommendations of the SEZ Authority. The Authority is vested with exclusive powers to regulate, implement, monitor and supervise all aspects of the SEZ regime detailed in the Act.

In **Egypt**, Law No.83 (2002) on Economic Zones of Special Nature applies to all SEZs - which are established only through presidential decree and governed by regulations adopted by the Prime Minister. Individual SEZ Authorities established for each of the zones shall have sole regulatory functions.

Similarly, **India's** SEZ Act (2005, Amended in February 2020) is adopted by Parliament; it extends over the whole of India. Areas designated as SEZ are demarcated by the central government, while individual SEZ authorities assume exclusive regulatory functions.

China is a notable exception - and for quite unique reasons. Decentralization of law-making power to the provinces has been in the making for several decades; from early 1990s, legislative powers were devolved to Provincial Committees (PCs/PCSCs) of SEZ cities - affecting Shenzhen in 1992 - which also empowered the Shenzhen Municipal People's

[27] SEZ ACT No.16 (2015): ACT of Parliament to provide for establishment of SEZ, promotion and facilitation of investors, development and management of enabling environment for such investments.

Government to enact local rules. The trend continued with Xiamen, Zhuhai and Shantou cities in the course of 1994/1996.

Accordingly, the 'Regulations on SEZs in Guangdong Province Approved by Standing Committee of National People's Congress (August 26, 1980)' declared that certain areas shall be delineated in the three cities of Shenzhen, Zhuhai, Shantou in the Guangdong Province for the establishment of SEZs. A Guangdong Provincial Committee for Administration of SEZs was set up to exercise **unified administration of special zones** on behalf of Guangdong Provincial Peoples Government. The Committee exercises all powers and task lines which a typical SEZ Authority carries out - including approval of investment projects, handling registration of industrial and commercial enterprises, land allotment and registration, and coordinating OSS.

China's experience is very peculiar, but in the context of policy decision making in Ethiopia, it is also important to note that China practices a one-party system where all political power is wielded by the Communist Party at all tiers. The Party and the Congress exercise complete policy framing powers nationally; hierarchically, also, both are present in every province and city of the Peoples Republic of China.

POLICY RECOMMENDATIONS

In light of the overwhelming state practice which is mainly informed by pragmatism and need for uniform application of laws, but also concretely building on the existing experience under the IP regime, Ethiopia should **opt for an approach where SEZ policy is exhaustively defined by a federal legislation, supplemented as necessary by dedicated sectoral rules,** and **executed through the agency of the Ethiopian Investment Board and the Ethiopian Investment Commission.**[28]

The legislation should:

a) **thoroughly define powers and responsibilities;**[29]
b) set out clear principles that require **its uniform application throughout Ethiopia** in respect of all SEZ activities, and
c) more importantly, define the **in-applicability of any other inconsistent law, standard, practice or administrative action, whether federal or regional,** affecting SEZs - unless the SEZ law provides for specific exemptions.

[28] Further discussions on governance models are provided under Section 6.
[29] This notably includes: transfer of developed, undeveloped SEZ land, leases, sub-leases, issuance of leasehold certificates; transfer of land to third parties for different purposes; rental/sell of buildings/sheds within SEZs; approval of BoQ; issuance of construction/use permits; construction development milestones; and administrative measures - all of which are offered within the OSS system.

6. SEZS' INSTITUTIONAL GOVERNANCE MODEL

6.1. INTRODUCTION

As indicated above, substantively 'SEZ laws' cover various matters - including the powers and responsibilities of SEZs supervisory and regulatory agencies. Countries have experimented on different models of institutional governance.

In this light, the question of **what model works best in Ethiopia and which agencies should be vested with SEZ policy execution powers** must be addressed clearly under the proposed SEZ policy and legal framework.

6.2. THE CURRENT APPROACH IN ETHIOPIA

Ethiopia's current IP policy and legal frameworks and the investment law identify two critical institutions as responsible for the implementation of the IP regime: the EIB and EIC. The laws vested a near-complete jurisdictional monopoly in the hands of both institutions.

Under Article 21 of the Investment Proclamation No.1180/2020, the EIB is tasked to exercise powers and duties specified under the laws enacted to regulate the designation, operation and supervision of industrial parks. More specifically, Article 29 of the IP Proclamation No.886/2015 established the Board as the regulatory organ responsible for designation and oversight of the administration and supervision of industrial parks. Similarly, Article 3 of the IP Regulation No.417/2017 refined the Board's power as involving:

- the provision of high-level guidance on the development, operation and management of IPs, institution building and control;
- the designation, amendment and cancellation of IPs;
- the passing of decisions on policy matters regarding IPs and end-users, and
- ensuring that all concerned government organs dedicate a sustainable system on OSS;

With respect to EIC, Article 38 of the Investment Proclamation No.1180/2020 tasked it to exercise powers and duties specified under the laws enacted to regulate the administration and regulation of IPs and create system for the promotion of public IPs. Further, Article 29 invested in the Commission the power of issuing permits to IP developers, IP operators and IP enterprises, and conclude agreements to that end; this power is further refined under Article 4 which gave it exclusive mandate to:

- recruit suitable IP developers and enterprises and conclude agreements with them;
- ensure full occupancy of IPs;
- facilitate OSS to IP enterprises;
- provide logistical and export support to IP enterprises;
- ascertain that land is prepared and designated as IP;
- ensure lease and sub-lease agreements are concluded and construction permits are granted in accordance with the system in place;
- ensure infrastructure is developed per the plans, and

- conduct studies to identify policy issues of relevance to IPs.

6.3. INSTITUTIONAL FRAMEWORK MODELS: OTHER COUNTRIES' EXPERIENCE

With regard to other countries' experiences, the same legislation specified above vested all SEZ-linked powers and responsibilities in different institutions.

Generally, **the state entity that oversees a SEZ program can be either an independent SEZ authority, or a ministry (usually the Ministry of Industry), or the national investment promotion agency (IPA).** In Africa, 25 of the 42 countries with SEZ policies - nearly 60 per cent - rely on an independent SEZ authority to regulate their zones, while eight countries - almost 20 percent - delegate the management of SEZs to IPAs.[30]

African countries with well-established SEZ programs tend to have autonomous authorities whose sovereignty extends outside ministries and other national investment institutions (e.g. IPAs); political commitment is ensured by placing the relevant ministries and government officials on the authority's board of directors. In some cases, SEZ authorities have been subsequently merged with IPAs.[31]

A key aspect of a SEZ institutional governance policy is **also that a SEZ regulator should be vested with sufficient autonomy regarding budget and administrative tasks.** Best practice suggests that the regulator should have fixed and variable budget components to facilitate effectiveness of operations, and its autonomy should be reinforced by providing it with more flexibility in terms of hiring, firing, salaries and promotions of staffers.

Coming to select countries' experience, in **Kenya**, the Cabinet Secretary issues required regulations on all aspects of designation, approval, establishment, operation and regulation of SEZs - based on recommendation of the Kenya SEZ Authority (SEZA). The SEZA is administered by a Board of Directors; the Board is entrusted with all powers necessary for proper performance of functions of the Authority.

On the basis of the regulation, the SEZA:

- administers OSS where entities channel all applications for permits, approvals, licenses;
- coordinates with other government and private entities;
- determines investment criteria and threshold;
- undertakes and approves the development, operation or maintenance of infrastructure;
- reviews applications and grants licenses to developers, operators, enterprises;
- promotes zones;
- handles administrative business regulations and services functions;
- recommends to Cabinet Secretary to suspend or cancel licenses of SEZ enterprise or developer;

[30] UNCTAD. 2021. Handbook on Special Economic Zones in Africa.
[31] Ibid.

- regulates access of non-licensed service providers;
- manages land uses, and
- maintains a register of enterprises and residents domiciled in SEZ.

In summary, the Kenyan system favored the establishment of **one Authority and one Board - including the Cabinet Secretary - as having exclusive mandate** on all aspects SEZ establishment and operations.

In **Egypt**, one national SEZ law applies to all SEZs having special nature. By decree, the President establishes one or more zones in the country and **institutes one Authority for each SEZ**. The Prime Minister issues executive regulations in respect of the decree.

Each SEZ Authority so established **shall have exclusive power for applying provisions of SEZ Act**. Again each SEZA has **a Board of Directors** formed by Decree of the Prime Minister; SEZA Board consists of Chairman of the SEZA - head of the Board, and others from government ministries, investors, and development companies as members. The SEZA Board is responsible for:

- taking all decisions relating to management, development and regulation of businesses of the SEZ;
- setting conditions for issuance of license for establishing any activity within the zone;
- establishing system for registration and authentication;
- establishing projects in the zone and issuing licenses,;
- forming systems/procedures on import, export, health, environment;
- issuing permits to occupy zones;
- dispensing decrees for dividing land;
- approving establishment of companies and recording them in Commercial Register;

While ownership of state lands and buildings within SEZ are transferred to the SEZA Authority, the Board of Directors is responsible for setting requirements, standards, and rules concerning urban planning, construction, zone planning, and specifications.

On the other hand, the SEZA sets-up and develops the zone and promotes and attracts investments. It has exclusive power on commercial registers, and approves articles of association of companies, registration, and allocation of area within the zone for service providing departments. The SEZA's chairman manages the Authority's affairs, and implements resolutions of the Board of Directors.

In **Philippines**, SEZs are created and mandated by legislation (Act) adopted by Congress of the Philippines. However, the bound of each zone is delineated by a presidential proclamation - upon recommendation of the Philippine Economic Zone Authority (PEZA) - in coordination with the municipal/city council and national or regional Land Use Coordination Committee.

All SEZs are operated and managed by PEZA, a sole regulator established under the Act and attached to the Ministry of Trade and Industry.[32]

In **India**, the SEZ Act extends over the whole of India. Areas designated as SEZ are demarcated by the central government which prescribes conditions (area, entitlements etc.).

The Central government shall by notification constitute **for every SEZ established one SEZ Authority bearing a specific name.**

A Board of Approval - constituted by the central government and headed by a higher officer from the Secretary of Commerce is responsible for promoting and ensuring the orderly development of SEZ, approving/rejecting the establishment of SEZs, granting of permit to operate in SEZ by developer, and issuance or suspension of developer and operator permits. The Board draws its membership from revenue, finance, science, technology, industry policy, defense, home affairs, agriculture, environment, urban development offices - all of whom are designated by the central government.

The SEZA has lesser role: it is a body corporate with public servant employees and consists of a Development Commissioner of SEZ (chair of SEZ), and officers from central government and entrepreneurs as members. It is responsible for:

- receiving all applications for setting up a unit within SEZ which shall then be submitted to the Approval Committee;
- rendering services - other than grant of license;
- implementing measures on the development of SEZ infrastructure;
- review of the functioning of the SEZ;
- coordinating single window clearance which is undertaken by a committee appointed by the central government.

The central government alone dictates requirements relating minimum area of land, and terms and conditions which developers shall undertake. However, state governments may notify policies for developers and units and take steps for enactment of any law (e.g. granting exemptions from state taxes, duties, and delegating state powers to the Development Commissioner).

Finally, in **China**, the experience is in sharp contrast as it has a central legislation and devolved significant powers to entities established at local governance tiers. For instance, the Regulations on SEZs in Guangdong Province stated that the **Guangdong Provincial Committee for the Administration of SEZs** shall be set up to exercise **a unified administration of zones** on behalf of Guangdong Provincial People's Government, a regional governance structure.

The Committee is responsible for creating favorable operating conditions to investors - including examining and approving investment projects, handling registration of industrial

[32] As of April 30, 2016, about 345 economic zones operate throughout the Philippines.

and commercial enterprises and land allotment, issuing registration certificates and land use certificates (after examination and approval), and coordinating OSS-linked working relations.

POLICY RECOMMENDATIONS

In relation to SEZ governance models in Ethiopia, the **options** are largely between establishing:

- **one national SEZ regulatory authority** having comprehensive powers - **with policy and supervisory oversight exercised by a Board** (the Kenyan, and in some measure, Philippine model), or
- **one SEZ authority for each of the SEZs** designated by the pertinent governance body - with **supervisory oversight exercised by individual boards** (Egyptian and Indian model), or
- one SEZ authority at **local level by investing/delegating** all regulatory and facilitation functions.

The recommendation is for Ethiopia's SEZ policy **to endorse option one - where SEZ policy is exhaustively designed and executed through the agency of the EIB and EIC - with the later bolstered through sufficient institutional autonomy over budget and employees' administration.** The following reasons are adduced as justification.

First, this option is consistent with a decade-long experience in Ethiopia where the EIB and EIC have already developed massive experience and institutional memory. It is more feasible and pragmatic to mend any gaps (if any) and concretely build on the existing practice under the IP regime - than to create a new SEZ government authority as a regulatory and facilitation agency.

Further, EIC is overseen by a high-level Board in which key ministries are represented - giving it leverage to effectively coordinate policies across different sectors; it also reports to the highest possible level of government (the Prime Minister); it is therefore little exposed to interference from line ministries - the very logic on which the call for the establishment of an independent authority (such as Zone Authority) is championed.

By law, EIC is also mandated to exercise both inherent and delegated powers belonging to multiple government agencies - an important consideration in ensuring efficiency of the OSS system on which one can build.

Second, establishing one SEZ authority for each of the SEZs designated (decentralized autonomy) may have the merit of zooming-in all regulatory and facilitation services that are offered to each SEZ and availing protection from multi-agency bureaucracy. It also encourages competition between zones.

However, in the Ethiopian context, this would be administratively expensive and complex. It entails replicating multiple government agencies (authorities) across all SEZs - small and big;

running such organizations would inevitably require significant management capabilities and financial resources.

Further, opting for such option - where numerous and independent SEZ authorities operate - could engender un-identical application of the SEZ regime across Ethiopia.

Third, granting the power to locally established SEZ authorities is theoretically conceivable and may encourage competition among regions and zones. However, the implementation of this procedure will likely involve huge investments to upgrade the learning curve. It also requires a full-scale delegation of federal powers in many regulatory streams - which is itself complicated.

Further, a decentralized autonomy also means that the zones will suffer from a broken link to the 'highest possible level of government' - which is very critical in the success of any zone.

Not least, the procedure represents a significant deviation from the existing experience and would certainly lead to disparities in the application of the broader SEZ national policy which aspires to ensure a certain degree of standardization and alignment across all zones.

7. OTHER SEZS REGULATORY MATTERS

7.1. ESTABLISHMENT/ENTRY REQUIREMENTS

7.1.1. INTRODUCTION

Most countries that set up SEZs put in place a set of criteria for investors to establish in SEZs. UNCTAD (2019) categorizes these criteria into three:

- a minimum amount of investment which sets out the base capital commitment required of a firm to establish operations within the zone;
- expectations of contributions to certain development goals such as job creation, integration with local industry and energy efficiency, and
- specific performance requirements which typically focus on employment-related obligations, export performance and skills transfer.

The UNCTAD report highlighted that entry and operational requirements are relatively more conventional across African countries than in other parts of the world. Worldwide only 40% of SEZs provide criteria that companies must meet to invest and operate within a zone; in Africa the proportion is almost double - just under 80%.[33]

In addition, requirements can be different between Export Processing Zones (EPZ) and other types of SEZs. Requirements in EPZs are generally stricter than those in other SEZs. For instance, in Egypt under the EPZ regime, investors are required to export at least 80% of their production, but under the SEZ regime there are no specific export requirements (Egypt, Law No.2002/83).

[33] UNCTAD. 2021. Handbook on Special Economic Zones in Africa.

Furthermore, in countries where the SEZ regime allows private (foreign or domestic) investment in zone development and operation, some countries have provided for a set of entry and establishment requirements specifically applicable to developers and operators.

7.1.2. SELECT COUNTRIES' EXPERIENCE

CHINA

The SEZ regime in China evolved with its broader development policy and experience on the ground. EPZS were first introduced in the early 1980s. They were then upgraded to SEZs by the mid-1980s. The policy decision for moving towards SEZs in China was aligned with the broader economic reform process.

In terms of entry and establishment regulation, China's SEZ regime made no distinction between FDI and local investments. Nor was there any equity limitation on FDIs or a requirement to form JVs. FDIs going into SEZs had the liberty to do so on their own or through JVs.

Also, in terms of sectoral regulation, China's SEZs are open to investments in a broad range of sectors - industry, agribusiness, tourism, logistics, real-estate, construction, R&D etc., although certain restrictions remain.

As far as the financial sector (banking and insurance) is concerned, China enacted a regulation 1985 regarding entry and operation of FDI or FDI-domestic JV banks in SEZs. For the first time, the regulation allowed FDIs and JVs to establish branches and subsidiaries within the four coastal SEZs. In 1986, eighteen FDI banks established branches within the SEZs.

The application for establishing an FDI or JV bank in SEZs is made to the People's Bank of China. The application would need to accompany, among other things, amount of operating fund by the bank and specific type of bank service to be provided.

Minimum capital is required for FDIs and JVs operating in financial services within SEZs - 80M Yuan (forex) with 50% paid-up capital for banks with HQ in SEZs. For branches, 40M Yuan (forex) operating capital was required.

As regards scope, the SEZ law defines a non-exhaustive list of financial services that can be provided in SEZs. While there is no explicit restriction, the provision of all/any service is not also automatic.

China also imposed requirements SEZ units to sale products in international market (export requirement). Sales in local markets form exception and need to be approved by the government/SEZ committee.

In terms of the application process, investing in China's initial SEZs requires securing approval in respect of key milestones: approval to locate within SEZs, approval to constitute a business (in the form of registration certificate), and approval for land use (land use certificate).

Investors are required to start construction design within six months after securing a land use permit, start actual construction within nine months, and commence production within twelve months.

INDIA

Similar to China, India's SEZ regime has evolved from its initial trial and testing with EPZs. Between 1965-2000, India experimented EPZs - with a very limited initial traction. In 2000, India upgraded its EPZs to SEZs and followed with regulatory reforms. Eleven new SEZs came into being in the five years between 2000-2005. In 2010, the number of approved SEZs reached 580 - though only 112 were operational or exporting. Currently, India earns close to $70B from exports in SEZs - while the investment generated is estimated at $83B.

The entry and establishment requirements for SEZ developers and operators are relatively well defined. For SEZ developers, a key requirement is the minimum amount of land secured. Such land requirement also defines the type of SEZ one can develop - a minimum of 1000 ha is needed for multi-sectoral SEZ; 100 ha or more is needed for sector-specific SEZ, 40 ha or more for FTZs, and 10 ha and beyond for non-conventional SEZs in sectors such as IT-enabled services, biotechnology etc.

More than half (50%) of the total areas must also be used for processing. Further, the law requires SEZ developers to dedicate at least 26% of SEZ space for facility development such as residence, recreational centers etc.

The government has also defined key guidelines that inform designation of land as SEZ. These include size of additional economic activity to be created, export of goods/services to be unlocked, investment (FDI and local) to be generated, job creation, and infrastructure development prospects.

The entry and establishment process and related approvals in India is only partially decentralized whereby investors are required to make an application before the state/regional government for consideration which will then forward the case to the central government (Indian Board of approvals) for decision.

On financial services within SEZs, offshore banking services are allowed for which investors have to make application and get approval from the Reserve Bank of India. Similarly opening an international financial service center is allowed with SEZs.

PHILIPPINES

The process leading to SEZs and its regulation in the Philippines is almost the same as that of China and India whereby a government-led EPZs regime of 1970-1994 grew into a private sector led SEZs regime since 1995. It transitioned into ICT-sector led SEZs regime since the beginning of 2000. As of 2020, Philippines is reported to have 407 operational SEZs and 144 in development stage.

Enterprises in SEZs are given 50-90 years renewable lease term. Investment that is fully owned by a foreign investor is required to export at least 70% of the goods/service. An investment can freely supply to the local market only if the equity limit of a foreign investor is not more than 40%. Exceptions are made for pioneer investors and those with equity amount exceeding $200,000.

KENYA

As discussed above, the 2015 SEZ Act gives the SEZ Authority the power to determine investment criteria - including investment threshold. The Authority is also given the power to recommend to the Cabinet Secretary a negative list of activities that are prohibited in special economic zones including an additional set of restricted activities. The Cabinet Secretary then issues Regulations per the Authority's recommendations.

The Act does not contain a specific provision on local content or export performance requirements. On the contrary, it gives licensed SEZ enterprises the right to export and sell products in the customs territory (the East African Community, including Kenya itself) in accordance with the applicable customs laws.

POLICY RECOMMENDATIONS FOR ETHIOPIA

The main purpose of entry and establishment requirements is to ensure the quality of investment. Depending on policy objectives, countries use incentives to nudge investors (especially foreign investors) to make sizeable investments, increase exports, etc; occasionally, countries set them as mandatory entry requirements. Commonly, incentives are created around these targets.

In the initial stages, countries have also used SEZs to pilot and experiment deeper reforms that were considered risky to apply in the broader economy.

In light of the foregoing discussions, key features of an effective entry and establishment requirement for SEZs - which may be emulated in Ethiopia include:

- objectivity and clarity of the entry and establishment conditions;
- simplicity of application processes, and
- the degree to which the interface between various government agencies is streamlined for decision making.

The entry and establishment requirements under the current Industrial Park laws in Ethiopia consist of minimum capital requirement, sectoral restrictions and export performance requirements. The application process involves a detailed project proposal, export or import substitution plan, environmental impact assessment report, and declaration of financial standing and a ten-year forecast.[34] The export performance requirement has been quite controversial with investors, and due to various factors, challenging to achieve.

While the current IP regime in Ethiopia focuses on export-oriented manufacturing, the proposed SEZ policy should **be able to provide for the development and operation of economic zones that span over a wide range of industries and deliver on varied objectives**. As such, it will be important for the law to be receptive of investments featuring different market orientations.

As noted above, the experience in other countries shows that it is not necessary to set up all policy objectives in the form of entry and establishment requirements. **Investors can be nudged towards desired policy objectives through various incentives.**

As far as capital requirements are concerned, it is not essential for an SEZ policy regime to expressly provide a different minimum capital requirement from that provided under the investment law.

On sectoral regulations, however, **the prospective SEZ law presents an opportunity for Ethiopia to pilot the gradual opening of otherwise closed sectors to foreign investment.** This is discussed in the subsequent section.

The function of entry and establishment requirements as a screening mechanism is not merely limited to enterprises entering SEZs. As important as this is, it is more critical to properly screen SEZ developers and proposed projects for the success or failure of a country's SEZ program depends on this procedure. International best practice informs that projects seeking SEZ designation should be rigorously screened for compliance with a minimum set of qualifying criteria. Lack of a rigorous screening procedure which allows for poorly structured, overly political, and potentially unsustainable projects will inevitably lead to failure of the national SEZ program.

7.2. SECTORAL PARTICIPATION OF FOREIGN INVESTMENTS, RESTRICTIONS, AND FOB/MULTI-MODAL REFORMS

7.2.1. INTRODUCTION

As noted above, SEZ regimes are used to implement deeper reforms for improved investment climate - with a possibility for gradual scaling to the rest of the economy. In this regard, SEZs are widely considered as key investment promotion tools in attracting FDI.

It is generally assumed that through adequate infrastructure and best practice, SEZs can, to a certain degree, compensate for an adverse investment climate which FDI would otherwise face in the wider economy.

In terms of FDI entry and establishment regulation, it was stated above that many SEZs provide investors with wider rights to establish their investments individually or through

[34] Industrial Park Council of Ministers Regulation No.417/2017. Art. 9.

joint ventures; the regulation and administration of businesses within SEZs should be guided principles of openness, competitiveness and transparency.

However, country experiences are varied in this regard. Decisions on the degree of FDI participation (or sector liberalization) within and outside of SEZs are made on the basis of specific policy considerations at national levels.

Again, while SEZ regulations may provide foreign investors with additional entry rights in sectors that are otherwise closed or restricted in the wider economy, it is also the case that distinctions between FDI and local investments are **defined under separate and more comprehensive investment legislation or related instrument - and not the SEZ law per se.** In fact, while countries stipulate for an SEZ regulatory entity to facilitate the registration and licensing of businesses aspiring to enter SEZs, none of the case study country legislation (in Egypt, Kenya, Philippines, India, and China[35]) had directly provided for a provision on FDI's participation or restriction.

In this light, Ethiopia's SEZ policy should offer **clear guidance on both issues, namely, the degree of liberalization sought within the framework of SEZs** and whether such decision **needs to be included under the proposed SEZ law or the investment regulation**.

7.2.2. SELECT COUNTRIES' EXPERIENCE

CHINA

In terms of countries' experience on FDI establishment within SEZs, China's People's Congress first promulgated its revised 'Foreign Investment Law and Implementing Regulations 2020'[36] - which shall be 'applicable to foreign investment within the territory of the People's Republic of China'. Under Article 4, the law stipulated the 'State shall implement the management system of pre-establishment national treatment and negative list for foreign investment' which will 'be issued by or upon approval by the State Council'.

Based on this direction, China issued its 'National Negative List for Foreign Investment 2020' on June 30, 2020, and on the same day, China National Development and Reform Commission and China's Ministry of Commerce announced the Negative List for Foreign Investment Access in Pilot Free Trade Zones 2020 (referred to as 'FTZ Negative List

[35] A notable exception, the Regulations on Special Economic Zones in Guangdong Province (Approved for implementation at the 15th Meeting of the Standing Committee of the Fifth National People's Congress on August 26, 1980), under Article 4, provided generically:
'… Investors may establish, with their own investment or in joint ventures with our side, all projects that have positive significance for international economic cooperation and technical exchanges, including industry, agriculture, animal husbandry, aquaculture, tourism, housing and construction, and research and manufacture involving high technology, as well as other businesses of common interest to investors and to our side.' **It did not indicate the full-story of negative listing China had adopted.**

[36] The Foreign Investment Law of the People's Republic of China. Adopted at the Second Session of the 13th National People's Congress on March 15, 2019. Promulgated for implementation as of January 1, 2020.

2020').[37] Under the Negative List, various restrictive formulations remain in place - affecting business-lines in transport, warehousing, postal services, information transmission, software/information technology services, leasing and business services.

KENYA

Kenya's SEZ law defined 'negative list' as referring to a list of activities not allowed to be undertaken by special economic zone enterprises under the laws of Kenya and those of the East African Community. The SEZ law indicated that the SEZ Authority shall have the power to 'recommend to the Cabinet Secretary a negative list of activities that are prohibited in the special economic zones - including an additional set of restricted activities under regulations made thereunder'.

PHILIPPINES

In Philippines, while the SEZ Act permitted products manufactured in zones to access retail markets in wider economy (subject to payment of taxes on raw materials), it also allowed the SEZ Authority to draw up a negative list of industries that could not do so - the objective being to protect the domestic industry. However, investment negative list is regulated by the 'Executive Order on Philippines Foreign Investment Negative List of 2018' - which is updated from time to time based on the government's need and interest to reform.

INDIA

In India, while the Board of Approval of SEZs is mandated to grant approval to developers or units within SEZs, the actual list of sectors in which an FDI engages in controlled by the 'Consolidated FDI Policy Circular of 2020'. This instrument is issued by the Department for Promotion of Industry and Internal Trade (FDI Division) of the Ministry of Commerce and Industry.

POLICY RECOMMENDATIONS: SECTOR LIBERALIZATION

A) While bearing in mind that SEZ laws do not usually list-out FDI restrictions, it is nevertheless important for Ethiopia's SEZ law to:
   - clearly indicate the broader policy imperatives of sector liberalization as relating to SEZs, and
   - further accommodate a **plain principle that caters for negative listing of sectors by amending** the existing investment regulation.

[37] Both the 'Foreign Investment Negative List 2020 and FTZ Negative List 2020' further opened the financial sector, abolished restrictions on ratio of foreign shares of securities companies, securities investment fund management companies, futures companies, and life insurance companies. In fact, in July 2019, the Office of Financial Stability and Development Commission of the State Council had announced 11 measures for further opening up the financial industry to the outside world.
On December 27, 2021, China issued a new version of the Negative List for Foreign Investment Access in the Free Trade Zone (FTZ negative list 2021) which introduced further liberalization.

This approach helps to ensure greater predictability and cohesion between the SEZ law and investment regulation; but more importantly, it enables to cater pressing SEZ-linked sector reforms more conveniently (as opposed to adopting a revised regulation through a different procedure).

B) Second, in the interest of ensuring greater transparency and certainty of activities prohibited for FDI participation, it is recommended and would also be in reading with best practice if **the Ethiopian Investment Board formally publishes, from time to time, Ethiopia's negative lists** applicable for the wider economy as well as SEZs.

C) In terms of liberalization of specific sectors within the framework of SEZs, the following list - **representing activities that should be fully open to FDI** - is recommended - which **must also be captured under the proposed SEZ law**.

The recommendations on sector openings are in reading with the overall trajectory of reforms in Ethiopia. In part, they are also based on specific studies and recommendations espoused by the pertinent sector agencies - including the Ministry of Transport and Logistics and the Ministry of Trade and Regional Integration. Not least, they are also informed by a key consideration, namely, the need for presenting end-users within SEZs (traders, manufacturers etc.) an opportunity to receive a more efficient and reliable services from highly competing and well-established FDIs that muster better resources, technology and know-how in certain sectors (e.g., logistics).

Activities directly linked to Ethiopia's SEZs objectives and should be fully open to FDI include:

- freight transport: reform measure entails removing the caveat under Article 4.14 of Regulation 417/2012 (restricts FDI participation only for services involving carrying capacities that exceed 25 tons);
- customs clearance: removing restriction under Article 4.23 of Regulation 417/2012 which reserved 'customs clearance' to domestic investors;
- wholesale trade: removing restriction under Article 4.4 of Regulation 417/2012 which reserved 'wholesale trade' to domestic investors (unless it is conducted electronically);
- import trade: removing restriction under Article 4.6 of Regulation 417/2012 which reserved 'import trade' to domestic investors;
- freight forwarding: removing restriction under Article 5.1.a of Regulation 417/2012 which reserved 'freight forwarding' to JV with a 49/51 caveat);
- shipping agency: removing restriction under Article 5.1.a of Regulation 417/2012 which limited the sector to JV with a 49/51 caveat;

Further, although not directly linked to SEZs, an SEZ regime should in principle provide investors with a wider scope of establishment and operating freedom for improved competitiveness. **In this light, the following sectors are proposed for FDI participation.**

Sector	Proposed reform
- banking, insurance and microfinance businesses; - retail trade; - primary and middle level health services; - construction and drilling services below grade I; - travel agency, travel ticket sales and trade auxiliary services; - tour operation; - operating lease of equipment, machinery and vehicles; - producing bakery products and pastries; - transport services; - grinding mills; - saw milling, timber manufacturing, and assembling of semi-finished wood products; - laundry services (excluding industrial scale); - security services; - private employment agency services;	should be removed from the domestic investors reserved list, and be open for FDI (with or without caveat);
- advertisement and promotion services; - accounting and auditing services;	should be removed from the JV with domestic reserved list and be fully open to FDI;

7.2.3. POLICY REFORM OF FOB AND MULTIMODAL TRANSPORT SCHEMES

While not related to sector opening directly, the continued implementation of current regimes relating to the Free on Board scheme and Multi-modal transport services **will likely create encumbrances on the efficient operations of the SEZ model** - hence requiring reform.

The FoB procedure (approved under the Logistics Sector Policy) and regulated by Directive No.858/2014 exempts only a few types of freight bound to Ethiopia from its application - otherwise obliging all other consignments to be imported solely through the employ of its procedures.

Similarly, the Logistics Sector Policy adopted by the Council of Minsters indicated that in addition to the ESLSE, the grant of Multi-Modal Operation permit to local investors (in the short-run) and to foreign investors in the longer run is believed to be a preferred alternative and policy direction. However, as multi-modal transport service is not yet open to international operators, this has left importing investors with no choice in terms of using their own logistics operators. This limitation can discourage investors from choosing SEZs in Ethiopia as preferred operational grounds. Such types of compulsory arrangements are also inconsistent with the liberal trading ecosystem intended to be created within SEZs.

In this light, it is recommended that the relevant instruments **should be qualifiedly reformed in order to allow investors choose their own logistics operators and not be**

obliged by mandatory provisions of the FoB Directive 858/2014 Article 4(1)(a)-(c). The **multi-modal transport services should be fully open** to international operators - an approach which is also in reading with Logistics Sector Policy.

7.3. LABOR REGULATION

7.3.1. INTRODUCTION

Labor and immigration issues of particular interest to SEZs include the protection of core employee rights, wages and benefits, labor supply, labor skills development, productivity and competitiveness, gender and social protection.

In the context of SEZs, best practice policies on labor revolve around establishing 'adaptable regulations' that demand countries to relax rigid and unrealistic requirements for hiring and dismissing workers, on employment of foreign workers, and working hours, conditions, and benefits.

World-wide, the experience of countries is rather mixed. While most SEZ countries have ratified the relevant ILO conventions, trends have been witnessed where SEZs had created negative social and environmental impacts - which include low environmental, health and safety standards, and the exploitation of workers.[38] Recurrent problems have persisted in the 'protection of fundamental principles and rights at work, in particular freedom of association, collective bargaining, gender equality', and other violations of workers' rights such as hours of work and health and safety measures.[39]

As a matter of approach, laxer labor standards - dictating lower obligations than the standards in the general labor legislation of a host country - are generally offered as part of incentives package applied in SEZs. Senegal and Nigeria are typical examples. Senegal's law gives broader flexibility on the recruitment of foreign nationals in SEZs, while Nigeria extends legal protection to SEZs against strikes or lockouts.[40] Again, many export processing zones around the world either establish separate legal frameworks for export processing zones or have a set of employment relations that regulate investments in distinct ways - according to the circumstances.

All in all, in many developing countries that opted for laxer approaches, such standards - coupled with weak enforcement capabilities - had exacerbated the problem of poor labor practices across SEZs.

On the other side, many countries have preferred to either apply the same labor regime as the wider economy or imposed mandatory requirements on SEZs to comply with higher

[38] International Labour Organization. 2017. Promoting Decent Work and Protecting Fundamental Principles and Rights at Work in Export Processing Zones. Report for Discussion at the Meeting of Experts. Geneva.
[39] Ibid.
[40] Newman, C., & Page, J. 2017. Industrial Clusters: The Case for Special Economic Zones in Africa. WIDER Working Paper. United Nations Wide University.

standards - including, for example, achieving a certain level of skills development of local personnel by limiting the recruitment of foreign labor.

Modern SEZs are moving away from the use of the so-called 'lax labor standards' as a value proposition. Instead, they tend to make positive contribution to social and corporate governance performance of countries - which has also become an element of competition for new SEZs.

7.3.2. OVERVIEW OF CURRENT PRACTICE IN ETHIOPIA

Ethiopia's Industry Park Proclamation provides that the prevailing laws of the country shall apply on matters of labor regulation within IPs. The Labor Proclamation (No.1156/2019) puts no limitation on rights of unionization, collective bargaining and strikes of employees within IPs; employees are also entitled to receive salaries, benefits and working conditions not less than those provided under the national labor law and other relevant laws.

Further, the law stated that labor agreements may be negotiated between an employer and employee taking into account the IPs' peculiar feature - although this leaves the contract arrangements open to interpretation.

In practice, the Ministry of Labor and its regional counterparts operate in tripartite forums with employees' and employers' representatives to manage core labor relations both **preventatively and through dispute settlement and social dialogue to ensure industrial peace and respect of workers' rights.** The agencies function by using alternative dispute resolution mechanisms as well as formal grievance channels. The IP law has highlighted that complaints and labor disputes shall be resolved by giving priority to alternative dispute mechanisms - based on voluntary submission by the parties. The labor law allows for the establishment of labor division courts, appellate courts, labor conciliators, and labor relations board; however, workers have reported being discouraged from taking cases to labor court.[41]

The establishment of the tripartite committee also failed to mirror the national tripartite institutions (government, employers and employees' **formal associations**); **industry park-wide employer and employee associations and representatives elected by actors themselves hardly exist.** This arrangement meant that workers' unionization rights are not implemented and workers cannot in any way engage in collective bargaining negotiations, collective agreements and strikes in defence of their rights.

POLICY RECOMMENDATIONS

On labor standards, Ethiopia's SEZ regulatory regime **should take account of developments in global best practice as its point of departure**. The gaps in implementation

[41] World Bank. 2022. On the path to industrialization: Review of Industrial Parks in Ethiopia.

notwithstanding, it would be a regress from global best practice for Ethiopia's SEZ law to expressly provide laxer labor and environmental standards.

In this light, **it is recommended that most viable options for Ethiopia would be to**:

- either retain the approach taken under the IP regulatory framework - which is to **faithfully maintain the same labor standards** as the rest of the economy outside of SEZs, or
- to strive for the application of higher labor standards applicable within SEZs.

The first option is the preferred option. In terms of implementation, this can be pursued through an investment promotion strategy that targets and attracts socially responsible investors - which mainly focuses on reputation-conscious companies. Potential investors are recruited based on their capacity to implement socially and environmentally responsible manufacturing, sourcing and trading in Ethiopia - which eventually presents the country to market itself as sustainable operational location that does not compromise on standards and compliance. Such approach puts the country on the right path on social sustainability in line with global value-chain trends.[42]

Having stated such overarching principle, the proposed SEZ law must also be a pragmatic document and should clearly stipulate rules that address ambiguous/borderline matters including the following.

- while a national wage policy is in the working, the SEZ regulator, in coordination with the Ministry of Labor, **should prescribe a master employment contract** for all SEZ enterprises defining minimum terms of employment - which provides salaries and benefits not less than those provided under the country's relevant laws;
- adopting **clear procedures for the realization** of the right to form and join trade unions as well as bargain collectively **in a manner that takes the unique attributes of SEZs;**
- establishment of a quadri-partite committee consisting of representatives from the Ministry of Labor, Ministry of Industry, SEZ developer/enterprises and SEZ employees within each SEZ - exclusively dedicated to the promotion of industrial harmony.

8. THE DESIGN AND ADMINISTRATION OF INCENTIVES

8.1. INTRODUCTION

Most SEZ laws include investment attraction instruments for zones. Incentives offered by SEZ host countries are generally considered a key element of the value proposition to attract FDI. However, the success and effectiveness of fiscal incentive packages to attract FDIs to developing countries had shown mixed results.

[42] Ibid.

Fiscal incentives **should be considered marginal SEZ policy tool** aimed at not losing investment to neighboring IP competitors, with otherwise comparable characteristics.[43] Studies have found that fiscal incentives are likely to be less important than other pull factors for investors (such as availability of labor, proximity to markets, presence of upstream suppliers, and political stability).[44]

8.2. TAX INCENTIVES

SEZs are subjected to the tax regime of their host country. However, tax incentives are often used to attract FDIs to SEZs. In most countries, SEZs enjoy certain fiscal benefits such as a partial or complete exemption from paying taxes or the application of a reduced tax rate. Tax exemptions or deductions may apply to the payment of corporate taxes, wages, salaries taxes, etc.

Regulatory competition between countries in terms of fiscal incentives has narrowed the margin of tax incentives offered to investors across SEZs. Some countries offer tax incentives based on specific performance requirements - for example training of personnel, use of local content, employment creation, or meeting of certain export targets.

For developing countries, tax incentives have sometimes drained the already scarce public resources. The OECD, the International Monetary Fund (IMF), the World Bank and United Nations have often argued that tax exemptions are ineffective in countries with deficits in infrastructure and governance.[45] Studies also show that tax incentives are mostly poorly designed, and do not have direct correlation with SEZ success in terms of job creation and export performance.[46]

Hence, Ethiopia's approach should be cognizant of the fact that the provision of generous tax incentive does not necessarily lead to success of SEZs.

This is also empirically proven. Interviews with IP investors on the Ethiopian IP regime's tax and duty-free incentives had found that Ethiopia's tax benefits are viewed as more generous than many in other countries;[47] however, IP investors also underlined that such tax breaks are inadequate to compensate for challenges related to infrastructure, completion of superstructures, and political unrest - which confirms international experience that fiscal incentives are not investors' key consideration.[48]

8.3. PREFERENTIAL CUSTOMS TREATMENT

Most SEZ laws establish a separate customs territory to attract investors.[49] Tariffs are often suspended or eliminated on designated imports into zones. Tariff suspension/exemptions

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[43] Ibid.
[44] Ibid.
[45] Gift M. 2021. Special Economic Zones: Economic Development in Africa. Palgrave Macmillan.
[46] Zeng, D. Z. 2018. *S*pecial Economic Zones: Lessons from the Global Experience. World Bank.
[47] World Bank. 2022. Note 41.
[48] Ibid.
[49] Zeng, D. Z. 2018. Note 46.

and reductions may cover inputs, capital goods, spare parts, as well as personal effects imported into zones.

The IP regime in Ethiopia suspends tariffs on all capital goods, construction materials, raw materials, spare parts (for limited period), motor vehicles, personal effects etc. The suspension of tariff on inputs is a privilege directly linked to a company's export performance.

8.4. NON-FISCAL INCENTIVES

Countries often provide special regimes on, *inter alia*, visa, employment of foreign nationals, foreign currency retention and usage as a part of their SEZs regulatory facilitation. For example, Philippines offers special non-immigrant visa with multiple entry privileges for foreign investors and immediate family members - along with visa facilitation assistance. It also allows the employment of foreign national in supervisory, technical, or advisory roles.

Kenya gives SEZ enterprises, developers and operators the right to work permits of up to 20% of their full-time employees - with the possibility of more for specialized sectors.

In Gulf and MENA countries, regulatory incentives in FEZs involve exemption from limits on foreign ownership of certain properties such as land that otherwise apply in the host economy. Labor market regulations are also eased in some zones, for instance through easier access to hire expatriates (Jordan and Kuwait), or by wavering national rules against limited duration employment contracts (Tunisia). Finally, countries that apply foreign exchange restrictions generally permit companies located within SEZs to operate outside this regulatory regime (e.g. Morocco, Syria and Tunisia).

In addition to this, some zones offer actual financial incentives, mostly in the form of low land rental and utilities rates (Egypt, Kuwait, Lebanon, Tunisia and UAE). More targeted financial incentives include subsidizing the training expenses of foreign enterprises (Jordan) and providing state aid for the acquisition of land and construction of production units (Morocco).

POLICY RECOMMENDATIONS FOR ETHIOPIA

In light of the above considerations, it is recommended that **the GoE should better use its limited resources on the timely provision of infrastructure, security and related public goods than expanding the incentives package to SEZ end-users.** In this regard, the proposed legal regime on SEZs **should not prescribe benefits beyond the incentives provided under the IP legal regime.**

On the other hand, the GoE **should review and revise some aspects of the incentives scheme under the IP legal framework** - such as corporate income tax exemption for IP investors that export over 80% of their output. This incentive may be considered a subsidy that is in violation of WTO's Subsidies and Countervailing Measures Agreement; tax incentives tied to minimum export quotas are deemed as illegal export subsidies.[50]

The conventional multi-year tax holidays given to investors as blank cheque are gradually phasing out and countries are recently moving into smart incentives. Smart incentives are those which are:

- targeted to specific policy objectives;
- performance-based (directly affecting investors' behavior as regards the specific policy objective they are targeting);
- objective and transparent (explicitly granted in laws and not subjected to case-by-case negotiations), and
- easier to administer.

The following are key policy objectives which the GoE should choose to accomplish through the development and operation of SEZs, and in respect of which tax incentives may be linked:

- attract high quality investment (make Ethiopia a competitive investment destination as compared to regional peers and competitors);
- export promotion;
- import substitution;
- forward and backward linkages with the domestic market;
- generating more and better-quality jobs;
- technology transfer and diffusion;
- attract high capital/sized investment;
- attract pioneer investors in key/strategic sectors that are yet to be developed in Ethiopia ;
- diversification;
- value addition;

In terms of incentive instruments, **though, it is highly recommended to avoid over-reliance on general tax holidays as the main incentive provision**, and rather **design more effective instruments such as nominal rates (tax rate deduction), allowances, credits, and depreciation.**

9. FACILITATION OF FOREX AND FINANCIAL SERVICES

9.1. INTRODUCTION

Fiscal incentives are deployed as one of the policy instruments to attract FDI and drive growth; as noted above, they are vital but not exclusively decisive factors in investment decisions. Literature on incentives is abound that fiscal incentives do little to embed investors in the domestic economy and even less to convince them to re-invest. Other factors, and most notably, **the degree and type of non-fiscal incentives offered to**

[50] World Bank. 2022. Note 41.

investments (exporters, producers and service providers in SEZs) in relation to foreign exchange transactions, retention and utilization, Franco-valuta schemes, export credit guarantees, loans, and the ability of investors to make remittances in convertible currencies - are extremely important and key determinants.

In the context of SEZs, the nature, scope and effectiveness of facilitation of such services availed to SEZ end-users would vary - depending on a country's monetary and exchange rate policy and broader understanding of the SEZ ecosystem and its objectives.

In this section, **only two service components** that are relevant to SEZ policy making are the subject of consideration: **forex retention/utilization and banking services.**

9.2. COUNTRIES' EXPERIENCE

Different countries have different policies on forex earning retention account - whereas nearly all economies in the world have liberalized their economies to allow significant FDI inflow in the financial sector.

SEZs end-users in **India** are allowed to retain 100 percent of their foreign exchange earnings in special foreign currency exchange accounts. However, SEZ units are required to be positive net foreign exchange earners. All foreign exchange funds held in the account shall be used for genuine trade transactions of the unit within the SEZ with a person resident in India or otherwise; they shall not be lent or made available in any manner to any person or entity resident in India not being a unit within the SEZ.

Beneficiary SEZ units are not subject to any minimum value addition norms or export obligations. For regulatory purposes, all goods flowing in to SEZs from the domestic tariff area are treated as export - while goods coming from SEZ to the domestic tariff area are considered as imports.

Under **Kenya's** SEZ Act of 2015, a licensed SEZ enterprise is granted a right to fully repatriate all capital and profits without any foreign exchange impediments.

Ethiopia does not have a **s**pecial forex-linked incentive policy for enterprises operating in IPs. The only exception relates to foreign exchange-based transactions between firms within IPs. National Bank of Ethiopia's Directive No.FXD/77/2021 - adopted to create transparency in foreign currency allocation and foreign exchange management - basically applies in the same way inside or outside of the IPs. The directive sets three priority areas for foreign currency allocations.

Under the existing laws, investments in Ethiopia can:

- retain and deposit in a bank account up to 20% of their foreign exchange earnings for future use in the operation of their enterprises;
- invoke Franco-valuta system to import raw material (enterprises engaged in export processing);
- receive export credit guarantee scheme;

- access finance through loans of up to 70% of capital requirements (as new establishments), and
- foreign investors can make specified set of remittances out of Ethiopia in convertible foreign currency.

POLICY RECOMMENDATIONS

In relation to SEZs, it is recommended that Ethiopia **should introduce a simplified forex regime - both as a form of incentive and as means of policy experimenting in financial liberalization.** How this is actually achieved against the backdrop of a structural forex predicament that continues to impact investments - merits a thorough investigation.

However, it must be absolutely clear that **Ethiopia's proposed SEZ regime could not succeed in meeting its lofty objectives without reforming services on forex availability and retention**.

In this light, the following **recommendations (reforming or reinforcing existing schemes)** are presented **in respect of forex retention and utilization** for policy decision and direction by the Government.

The overarching principle that informs policy decision is that **incentives offered shall be predicated on and specifically linked to a policy target** - **which is to facilitate forex-linked conditions that ensure the effective operation of SEZs and address the fundamental operational challenges of such investments** - so that they would be able to meet national policy expectations on job creation, exports, economic diversification, and building of productive capacity.

Further, since not all SEZ end-users have the same feature, needs and operational challenges, forex-linked incentives **may, depending on the circumstance, be linked to specific performances (for example exports), and be tailored.**

Learning from countries' experience, Ethiopia's forex policy should also be crafted in plain language that **rewards SEZ units focusing on strong backward linkages and minimize national dependence on imports**.[51]

In specifics, **the following recommendations are presented as informing SEZ policy content**.

a) so far as imports flowing into SEZs are concerned, SEZ units should be free to source and use their hard currencies;

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[51] Different countries have different stories in achieving the objective of increasing foreign exchange earnings from SEZ. Those countries that have success stories of achieving foreign exchange earning includes Republic of Korea, Indonesia, Philippines, Mauritius, Costa Rica and Hondurans.
Other countries like Guatemala, Srilanka and Mexico are not achieving their objective of increasing forex earning through SEZ development.
The discrepancy between objectives and performance in forex earning is because of weak back ward linkage (use of little inputs from the domestic market) and high import dependency of SEZ activity and impact of certain export market access (Gokhan and James. 2008.).

b) investors within SEZs should be allowed not only to open and hold foreign currency account, but also conduct foreign exchange transactions through commercial banks domiciled within the SEZ or with other banks;
c) it should be possible for transactions between units within SEZs, or between SEZ units and host economy actors, or involving exports to other country to be facilitated in hard currencies;
d) the existing retention policy of the NBE which allows 20% retention to exporters is not consistent with international best practice; NBE should craft a SEZ-specific policy which relaxes its current regime and affords retention rights ranging from 30-100% based on various considerations - including the nature of investments (for example traders, import substitution manufacturers, export-driven manufacturers etc.), the degree of an investor's focus on backward linkage, and dependency on imported inputs etc.;
e) in principle and subject to certain considerations regarding the nature of businesses, SEZ units should strive to be positive net forex earners;
f) SEZ units that possess foreign currency in foreign currency account or retention account should be able to enjoy a right to fully repatriate all capital and profits without any foreign exchange impediments;
g) SEZ units who have no enough foreign currency in a foreign currency account or retention account to repatriate profits, interest payments or other payments shall apply their demand to authorized banks within the SEZ and get facilitated/ prioritized service.

Further, the following recommendations (reforming or reinforcing existing schemes) are presented in relation to **banking services for policy direction** by the Government.

a) procedures shall be established to select and permit commercial banks - both local and international - to carry out banking business within SEZs; NBE shall set out rules and guidelines for choosing banks that are authorized to operate within SEZs;[52]
b) authorized banks shall enjoy right of engagement in permissible activities that are tuned to the nature and demands of SEZs;

[52] When we see countries' experience in terms of banking service, almost all SEZ countries are open for foreign and local banks to operate within SEZs - based on authorization by Central Banks.
Allowing foreign banks to join SEZs has its own pros and cons.
- The advantages include increasing investors' confidence in terms of accessing international banking service and LC opening guarantee; knowledge transfer; efficiency; decrease of overhead costs which increases competitiveness of importers and exporters; promotes competition among banks; contributes to economic growth; stable source of fund.
- Disadvantages include: requires strong institutional framework; skews credit allocation to large enterprises; negatively affects infant local banking; bank crises may happen when foreign banks shift funds to more attractive markets.
Weighing on the above, it is important to think about allowing banks to join SEZs, which can be in the form of limited branch in SEZs or through Joint Venture with domestic commercial banks.

c) the sources of fund of such banks may include deposits from non-bank customers such as multinational/international corporations, non-resident or resident persons or entities, approved enterprises within SEZs, regional financial agencies, inter-bank borrowing within SEZs, equity capital and such other sources of funds as may be approved by NBE;

d) authorized banks should be able to apply funds at their disposal to loans and advances for residents and no-residents, investments, settlements of operational expenses, payment of dividends, payment of interest on deposits, payments for imports, and such other utilization of funds as may be approved by NBE in consultation with the SEZ regulator.

10. SEZ AND CUSTOMS ADMINISTRATION

10.1. INTRODUCTION

Most SEZ laws provide for a special customs regime that eliminate or reduce tariffs on goods, plants or machinery imported into zones; they also offer expedited and simplified customs procedures which address trade facilitation issues - including reducing waiting times at borders, removing cumbersome formalities, and clarifying rules and regulations. Countries also arrange the possibility of dealing with tax records for import and export procedures entirely online - thereby reducing bureaucracy and administrative burdens.

Still others aim to reduce formalities through, for instance, the removal of import license requirements.

10.2. FACILITATED CUSTOMS PROCEDURES

A SEZ regulator should work closely with a customs agency to effectively administer customs procedures. The regulator should seek to ensure that all customs procedures are administered efficiently - using streamlined submission and approval of documents and fast-tracked clearance at the SEZ, rather than at a point of entry. Best practice for SEZ customs regimes require that all non-prohibited imports enter on duty-free basis and suspend value added taxes (VAT). They also grant enterprises freedom to sell internally and engage in limited duty-free consumption.

Moreover, good practice in customs include the adoption and application of streamlined World Customs Organization Kyoto Convention-compliant customs procedures such as risk-based inspections, coordinated inter-agency inspections, single and simplified and anticipatory declarations, on-site clearance, customs clearance credit lines, and fast-track (green channel) clearances for certain items.

Ethiopia’s Industrial Park law designates parks as customs-controlled areas (partially or fully) with simplified customs procedures and exemptions. The IP Directive on its part requires that IPs’ customs system shall be designed by the Customs Commission with simplified and automated procedures, and provide for post-entry, risk-based inventory checks in line with good practices.

However, going forward, it would be important to build on existing experiences and further reform custom procedures in a manner that ensures proper and efficient operation of SEZs. This is particularly relevant given that the SEZ regime presents a number of new actors, activities and regulatory subject matters.

In this light, the following **conceptual and procedural reforms are recommended for inclusion** under the proposed SEZ policy framework or customs directive.

POLICY RECOMMENDATIONS

a) For Customs Commission to prepare and issue a specific SEZ-focused guideline that directs the implementation of a simplified customs procedure across SEZs;
b) in meeting with the nature of SEZs, draw an exception to the customs law so as to treat SEZs as 'part of Ethiopia's territory where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs';
c) to permit goods entering SEZs stay within zones for indefinite period of time (hence lifting qualifications under the current law where air-cargo can only stay in warehouses for 10 days, and land-transported cargo for 15 days);
d) in meeting with the nature and business model of SEZs, conceptually treat goods and services destined from the customs territory to SEZs as 'exports' (which in effect changes the status of such activities under the IP practice where the process would have been considered as national transaction);
e) in meeting with the nature and business model of SEZs, conceptually treat goods and services destined to the customs territory from SEZs as 'imports' - (which in effect changes the status of such activities under the IP practice where the process would have been considered as national transaction);
f) allow uni-modal and multi-modal consignments destined to SEZs to move in transits without completing customs formalities on the goods imported - by only requiring compliance with a transit guarantee system (bond);
g) exempt goods imported into SEZs not fulfilling the requirements of relevant laws to be exported from zones or the customs territory without payment of 5 percent charges (which would otherwise apply under the customs law);