

**AN ANALYSIS OF THE LEGISLATIVE FRAMEWORK  
GOVERNING SPECIAL ECONOMIC ZONES IN KENYA**

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**DECLARATION**

I **GACEMBUI TABITHA WATHUTI** do hereby declare that this project paper is my original work carried out by me as part of the fulfillment of the requirements of obtaining a Master of Laws (LL.M) at the University of Nairobi, School of Law and has not been submitted for examination in any other University. I also declare that any secondary information used has been duly acknowledged in this project paper.

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## **DEDICATION**

To my beloved family, especially my mother and father for their unwavering support throughout this work and the entire Master of Laws program. They have shown me what great sacrifice is all about and it is because of them I have been able to complete the program.

To my sisters, for believing in me and for their endless support during the period of my studies.

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### **CHINA**

The 1980 Regulations on Special Economic Zones in Guangdong Province

The 1984 Regulations on Labor Management in the Xiamen Special Economic Zone

The 1984 Regulations on the Administration of the Registration of Enterprises in the Xiamen  
Special Economic Zone

## ACRONYMS

**AEZ** ..... Africa Economic Zones

**BRF** ..... Belt and Road Forum

**CS** ..... Cabinet Secretary

**EACC** ..... Ethics and Anti-Corruption Commission

**EPZ** ..... Export Processing Zones

**FDI** ..... Foreign Direct Investment

**FIAS** ..... Foreign Investment Advisory

**GDP** ..... Gross Domestic Product

**IP's** ..... Industrial Parks

**NEMA** ..... National Environment Management Authority

**NPC** ..... National People's Congress

**SEZ** ..... Special Economic Zone

**SEZA** ..... Special Economic Zones Authority

**USD** ..... US dollar

## **LIST OF CASES**

*Tatu City Limited & another v Ethics & Anti-Corruption Commission & another [2018] eKLR*

## **ABSTRACT**

This study examines the legal framework governing Special Economic Zones (SEZs) in Kenya and China. This is with a view to identifying the gaps that exist in the Kenyan model and subsequently recommending an appropriate framework which will fill the gaps and thus enable the successful implementation of the model in Kenya. It argues that despite the fact that there is in place a legislative framework governing SEZs in Kenya, the same is marred with various inadequacies which can lead the country in failing to achieve economic liberalization as envisioned in the economic pillar of Vision 2030. These inadequacies fall into two main limbs as discussed below.

The first limb is the non-implementation of the existing provisions of the law on the criteria of setting up these zones. While the law clearly provides that factors such as land availability, infrastructure, topography, construction constraints, presence of other business enterprises, effect of the SEZs on the society and the environment have to be carefully considered before setting up these zones, politicians have on numerous occasions undermined the role of the SEZ Authority such that some zones are set up as a tool for political leverage without consideration of this factors.

The second limb is the failure of the legal framework to address important issues such as labour despite the fact that one of the factors that led to the failure of Export Processing Zones (EPZs) in the country was exploitation of workers and labour rights abuses in the zones. The fact that Kenya intends to achieve economic liberalization through the use of this model makes it necessary for the country to address these two limbs to enable the country to attain the economic pillar of Vision 2030. Once these two issues are fully addressed, SEZ's will be a promising strategy for attracting FDI in the country.



This study goes further and focuses on SEZs in China especially the history of SEZs in that country and their legal and institutional framework. China serves as a good benchmark since it has over the years developed strong bilateral relations with Kenya which continue to yield benefits for both countries economically. The Africa Economic Zone SEZ in Uasin Gishu County for example is a product of the economic cooperation between Kenya and China.

The research project in the last chapter recommends that the legal and institutional framework in Kenya should be strengthened in order for the country to fully benefit from this model. This can be done by the amendment of the SEZ Act and regulations to include labour issues which are completely left out. Other recommendations are strict adherence to the provisions of law governing the criteria for setting up SEZs in the country, skills training, provision of investment incentives, institutional autonomy for the zones to make their own laws and elimination of corruption. Once the existing legislative weaknesses are addressed, the country will be able to finally achieve economic liberalization in accordance with the economic pillar provided in Vision 2030. The study finally concludes that despite China's success in this model, the model nevertheless has to be carefully implemented and tailored in accordance to Kenya's specific conditions for it to achieve the desired results.

## CHAPTER 1: INTRODUCTION

Kenya has in the recent years adopted the Special Economic Zones (SEZs) model in various locations countrywide in an attempt to achieve economic development as highlighted in its Vision 2030.<sup>1</sup> SEZs have been defined as geographical areas which have been set aside by the government to offer certain benefits to businesses which are operating within the zones.<sup>2</sup> Some of these benefits include tax holidays, simplified customs procedures for investors and availability of good infrastructure which are not available to the rest of the country.<sup>3</sup>

One of the key pillars in Vision 2030 is the economic pillar which Kenyan Government aims to implement through the SEZ model. The introduction of these zones was as a consequence of the failures of the Export Processing Zones (EPZs) which were unsuccessful in achieving economic liberalization for Kenya. This has been done through legislation such as the Special Economic Zones Act, 2015 and the Special Economic Zones Regulations, 2016.<sup>4</sup>

This study will examine the legislative framework governing SEZs in Kenya. It will focus on the legislative and implementation challenges which exist that Kenya should first address in order for the country to fully benefit from this model. It further emphasises on the need for an appropriate SEZ legislative framework which will bring about economic development for Kenya as provided under the economic pillar of Kenya's Vision 2030.

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<sup>1</sup>Ministry of Trade, Industry and Cooperatives, "About Vision 2030," (2012) <<http://www.vision2030.go.ke/about-vision-2030/>>accessed on 20/11/2017).

<sup>2</sup> Section 4(4) of the Special Economic Zones Act, 2015.

<sup>3</sup>Foreign Investment Advisory Service, "Special economic zones: Performance, lessons learned and implications for zone development" (2008) <<http://documents.worldbank.org/curated/en/343901468330977533/Special-economic-zone-performance-lessons-learned-and-implication-for-zone-development>>accessed on 18/11/2017).

<sup>4</sup> Ibid.

Export Processing Zones (EPZ), is another model that was introduced by the Kenyan government to enable it achieve the much desired economic development for the country. However, over the years critics say the EPZs failed to achieve their objectives, mainly due an inadequate legal framework and as such did not help the country generate substantial revenue. Not surprisingly, the State has therefore proceeded with another improved version of EPZs, the SEZs.<sup>5</sup>

For any SEZ model to succeed, it must have an adequate legislative and institutional framework touching on issues such as criteria of setting up the zones, infrastructure, environmental and economic effects of the zones, infrastructure and the socio-developmental effects of the zones. It is therefore of utmost importance for these issues to be addressed early enough for this model to work in Kenya. For the new SEZ regime to be successful and avoid failures of the Export Processing Zones, the loopholes in the current legislative framework need to be dealt with.

### **1.1 STATEMENT OF THE PROBLEM**

SEZs are absolutely essential to a country and Kenya cannot afford to lag behind. For Kenya to achieve economic liberalization which attainable through an increment in foreign direct investment (FDI) inflows into the country, there must be in place an effective legal framework. The SEZ legislative framework in Kenya is fairly new having been enacted less than five years ago. Overtime, there have been various inadequacies in the legal framework which fall into two main limbs.

The first limb is the non-implementation of the existing provisions of the law on the criteria of setting up these zones. While the law clearly provides that factors such as land availability,

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<sup>5</sup>Mireri C, 'The Impact of Export Processing Zone Development on Employment Creation in Kenya.(2000)21 Singapore Journal of Tropical Geography 149–165.

infrastructure, topography, construction constrains, presence of other business enterprises, effect of the SEZs on the society and the environment have to be carefully considered before setting up these zones, politicians have on numerous occasions undermined the role of the SEZ Authority such that some zones are set up as a tool for political leverage without consideration of this factors. The second limb is the failure of the legal framework to address important issues such as labour despite the fact that one of the factors that led to the failure of EPZs was exploitation of workers and labour rights abuses in the zones.

The fact that Kenya intends to achieve economic liberalization through the use of this model makes it necessary for the country to address these two limbs to enable the country to attain the economic pillar of Vision 2030. Once these two issues are fully addressed, SEZ's will be a promising strategy for attracting FDI in the country.

## **1.2 STATEMENT OBJECTIVE**

The general objective of this study is to analyse the legal framework governing SEZs in Kenya and China. This is with a view to identifying the gaps that exist in the Kenyan model and subsequently recommending an appropriate framework which will fill the gaps and thus enable the successful implementation of the model in Kenya.

### **1.2.1 SPECIFIC OBJECTIVES**

1. To analyse the legal framework relating to SEZs in Kenya.
2. To investigate the gaps that exist in the legal framework.
3. To analyse the legal framework relating to SEZs in China.
4. To examine appropriate ways to address the issues that emerge from the study.

### **1.3 RESEARCH QUESTIONS**

1. What is the legal framework dealing with SEZs in Kenya?
2. What are the gaps and inefficiencies that exist in the legal framework?
3. What is the legal framework dealing with SEZs in China?
4. How can the shortcomings in the Kenyan legal framework be addressed?

### **1.4 RESEARCH HYPOTHESES**

This study tests the hypothesis that:

1. Proper legislation, policies and regulations on SEZs are a necessary tool for Kenya to achieve economic liberalization as envisioned in the economic pillar of Vision 2030.

### **1.5 JUSTIFICATION OF THE STUDY**

This paper aims to help the reader understand the need of an effective regulatory framework governing SEZs in Kenya. The existing literature on this subject in the country fails to address the issue of the lack of implementation of the set out criteria of setting up SEZs in the country as well as the failure of the legal framework to address labour issues. The information generated by this paper will therefore serve as an important contribution to knowledge for academic, research and other institutions dealing with SEZs like the Ministry of Industry, Trade and Cooperatives.

### **1.6 THEORETICAL FRAMEWORK**

This study relies on two main schools of thought economic development and legal realism.

#### **1.6.1 Legal Positivism**

Legal positivism holds that true law in any society emanates from the sovereign or from certain recognized institutions such as the legislature and courts of law.<sup>6</sup> Hans Kelsen is well known

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<sup>6</sup>Leiter Brian, *Why Legal Positivism?* (University of Chicago Public Law & Legal Theory Working Paper, (2009).

when it comes to the development of this theory of law. According Kelsen's theory, the law was devoid of all extraneous factors out of what was created by the courts and legislature<sup>7</sup>.The law was therefore pure according to him from factors such as politics, culture, sociology, religion, economics and geography.

Kelsen however received criticism on his theory with various critics stating that it was not possible to purify the law from all forms of “impurities” which include moral, political, metaphysical and psychological considerations<sup>8</sup>.His critics were of the view that true law is inclusive of factors such as politics, culture, sociology, religion, economics and geography.

This theory helps us understand why the legal framework is the way it is when it comes to SEZs in Kenya as a creature of the legislature. However, just like the critics of Kelsen, it is important for the law makers to take into account moral, political, sociological, geographical and economic considerations when enacting laws governing this model. An example of this is when the SEZ Authority in Kenya takes into account social, environmental, economics, topography and culture factors when considering whether proposed SEZ enterprises can be granted licenses to operate in the country.<sup>9</sup>

### **1.6.2 Legal Realism**

Legal realism brought about a change to what was considered as the study of the law. Earlier on, the study of the law was deemed to comprise only the written laws and the legal systems that existed.<sup>10</sup>Legal realism shifted this approach of studying the law to include social-cultural considerations. The realists believed that the formal approach of the study of law did not take

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<sup>7</sup>Edwin W. Patterson, “Hans Kelsen and His Pure Theory of Law”, (1952) 40 Hein online 5.

<sup>8</sup> Ibid.

<sup>9</sup> Section 13 of the Special Economic Zones Regulations,2016.

<sup>10</sup>Us Legal Realism Movement Administrative Law Essay. “Law Teacher All Answers Ltd. 10 (2017).

into account the social factors within society and thus rigid in nature .This led to the change of what can be described as law in action against law in books.<sup>11</sup>

Oliver Wendell Holmes rejected the notion that the law was an abstract concept not affected by external factors. He was of the view that the study of the law was inclusive of moral, political, social and economic factors that judges needed to consider when making laws.<sup>12</sup>This theory helps us to understand that there are other factors that need to be looked at when coming up with the legal framework governing SEZs in Kenya. Economic and social considerations like increased FDI, poverty alleviation should be some of the factors that law makers should have in mind.

The study of SEZs is multidimensional cutting across various fields such economics, geography, culture, sociology and political science. It is therefore important for the law makers to take into account these considerations when enacting laws governing this model. An example of this is when the SEZ Authority in Kenya takes into account social, environmental, economics, topography and culture factors when considering whether proposed SEZs can be granted licenses to operate in the country.<sup>13</sup>

## **1.7 RESEARCH METHODOLOGY**

The study employs qualitative methods of research specifically desk review. The methods of qualitative research undertaken in this study include library research and internet searches. This research entails the collection and review of data from existing resources. No fieldwork has been carried out when conducting this study.

The study mainly focuses on SEZs in China especially the history of SEZs in that country and their legal and institutional framework. It also focuses on the strengths of this model in China,

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<sup>11</sup> Ibid.

<sup>12</sup>Carrese, P. 2014. *Holmes, Jr., Oliver Wendell (1841–1935). The Encyclopedia of Political Thought.*1694–1695.

<sup>13</sup> Section 13 of the Special Economic Zones Regulations,2016.

make a comparison of this model in Kenya and further identifies the areas for reform that Kenya should adopt.

China serves as a good benchmark because it has over the years developed strong bilateral relations with Kenya which continue to yield benefits for both parties economically. The Africa Economic Zone SEZ in Uasin Gishu County for example is a product of the economic cooperation between Kenya and China.

I will also rely on both primary and secondary sources. Primary sources relied on are relevant statutory provisions from various legal instruments while the secondary sources will include journal articles, newspaper, web resources, books, journals, reports, thesis, dissertations, policy papers, government's notifications & circulars etc.

## **1.8 LITERATURE REVIEW**

### **1.8.1 Introduction**

This section of the study provides an overview of the literature reviewed in relation to the statement problem. The study discusses the importance of the SEZ model not only in Kenya but the rest of the world .It also discusses the role of an effective legal framework for a country to fully benefit from this model. This study further identifies the gaps in the Kenyan SEZ legal framework and goes further to discuss the ways to fill these gaps by making various important recommendations to the framework.

The current gaps in Kenya's legal framework fall under two main limbs .The first limb is the non-implementation of the existing provisions of the law on the criteria of setting up these zones. While the law clearly provides that factors such as land availability, infrastructure, topography, construction constrains ,presence of other business enterprises, effect of the SEZs on the society and the environment have to be carefully considered before setting up these zones, politicians have on numerous occasions undermined the role of the SEZ Authority such that some zones are



set up as a tool for political leverage without consideration of these factors. The other limb is the failure of the legal framework to address important issues such as labour despite the fact that one of the factors that led to the failure of EPZs was exploitation of workers and labour rights abuses in the zones.

### **1.8.2 Importance of SEZs**

Thomas Farole in his article argues that African SEZs play a major role in many African countries in boosting their economic capacities. He goes on to argue that earlier failures of this model across the African continent have been a result of non-implementation of the existing legal frameworks<sup>14</sup>. This article forms a basis of my arguments in my research paper as it captures the need of implementation of the existing legal frameworks.

According to Sean Woolfrey, SEZs when fully implemented are an important tool of economic development. Woolfrey contends that there are various direct benefits achieved through the use of SEZ's such as direct job creation; increased FDI; and increased exports.<sup>15</sup> Woolfrey further contends that SEZs bring about long term or indirect benefits such as indirect job creation, upgrading of skill and industries, poverty alleviation and technology transfer.<sup>16</sup> These short term and long term benefits form a basis of my theoretical framework as discussed earlier and hence form an important part of my entire research.

### **1.8.3 Effective Regulation of SEZ's**

According to Farole, for an SEZ model to be successful it has to result in both short term and long term benefits such as FDI, increased exports, creation of jobs, technology and skills transfer. Farole finds in general that African zones have been unable to achieve success in implementing this model compared to East Asia countries like China. One of the problems he

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<sup>14</sup>Farole T, '*Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience*'. (1<sup>st</sup> edn, Washington, DC: World Bank, (2011).

<sup>15</sup>Woolfrey, S, '*Special economic zones and regional integration in Africa*,' (Nairobi, Trade Law Centre, 2013)

<sup>16</sup> Ibid.

identifies is inadequate legal and policy frameworks. He further adds that these poorly drafted laws are a result of lack of funding and lack of political goodwill and incentives to draft proper laws.<sup>17</sup>

Otiato Guguyu examines the various legal issues which arise in the current legal framework governing SEZs in Kenya. One such issue is the arbitrariness behind how the SEZ's are created. He questions in particular the criteria used to set up these zones especially when these zones are used by politicians for political leverage during election periods. Guguyu further notes that when these zones are created arbitrarily a chance arises for companies to form subsidiaries in SEZ's to evade paying taxes.<sup>18</sup> While Guguyu identifies this area which forms an integral part of my study he fails to address other issues such as labour rights which have been completely left out by the legislation.

Thomas Farole, in his paper highlights some lessons that SEZs in Africa need to adhere to in order to be successful. Firstly, according to him the zones must be located in areas away from political interference. Secondly, he is of the view that the plans used in designing these zones must be clear and that studies should be done on the zones to ensure they have economical value in the long term. Thirdly, he advocates for a sound legal and institutional framework governing these zones. This paper forms part of my research paper more so in my last chapter on conclusions and recommendations as it looks to the various ways in which SEZs can succeed in Kenya.<sup>19</sup>

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<sup>17</sup>Farole T, *'Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience'*. (1<sup>st</sup>edn, Washington, DC: World Bank, 2011).

<sup>18</sup>Otiato Guguyu and Macharia Kamau, 'Is Kenya overbanking on new Special Economic Zones to drive growth?' (Nairobi, July 25<sup>th</sup> 2017)<sup>2</sup>

<sup>19</sup>Thomas Farole, "Special economic zones: What have we learned?," (Washington DC, World Bank, 28 September 2011).

Farole<sup>20</sup> emphasises the need of a sound legal framework governing SEZs. He states that the lack of proper laws and regulations lead to the downfall of this model leads to failure of SEZs. He goes further to examine the importance of licensing regimes, a role which is critical and in Kenya is played by the SEZ Authority.<sup>21</sup>

Thomas Farole and Lotta Moberg in their paper examine the status of SEZs in African countries. They argue that most zones fail due to flaws in the political economy. They propose a ‘robust political economy’ as the best solution for these zones to succeed in Africa. They note that the government of any country plays an integral role in promoting the growth of these zones through provision of incentives, funding and formulation of proper legal frameworks. This Paper will form an important foundation for my research as it looks into the manner in which Kenya can replicate the success of China in Chapter three and four and this paper.<sup>22</sup>

In 2008, a study was undertaken which examined lessons that can be learned after thirty years of existence of economic zones. From this study, a template of best practice was developed for the purposes of assisting countries come up with their regulatory framework governing SEZs.<sup>23</sup> According to the report, the incentives which best increase FDI for a country comprise of tax holidays, simple exit and entry procedures for foreigners, good infrastructure and elimination of import and export duty.<sup>24</sup>

Theodore Moran in his paper argues that there are various factors that can result in the failure of the model. This includes poor infrastructure, high taxes, lack of agencies to promote the

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<sup>20</sup>Farole T, *‘Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience’*. (1<sup>st</sup> edn, Washington, DC: World Bank, 2011)

<sup>21</sup> Section 11 of the Special Economic Zones Act, 2015.

<sup>22</sup>Farole, Thomas, and Lotta Moberg., *‘It Worked In China, So Why Not In Africa?: The Political Economy Challenge Of Special Economic Zones’*, (Helsinki: UNU-WIDER, 2014).

<sup>23</sup>Foreign Investment Advisory Service, “Special economic zones: Performance, lessons learned and implications for zone development” (2008) <http://documents.worldbank.org/curated/en/343901468330977533/Special-economic-zone-performance-lessons-learned-and-implication-for-zone-development>> accessed on 18<sup>th</sup> November 2017.

<sup>24</sup>Ibid.

investments in the zones, high expropriation rates and bad business environment within the zones

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While most literature looks at the importance of a comprehensive legal and institutional framework governing SEZ's, there is little to no literature on the legal and institutional weaknesses on the model in Kenya. My study therefore aims to fill this gap and recommend ways to revise these laws in order to enable Kenya attract the much desired FDI.

## **1.9 LIMITATIONS**

As the title of this thesis suggests, the focus of this study is the SEZ model in Kenya and China. The comparative study on the Chinese model is only for purposes of establishing the best practices Kenya can learn from it and the failures it can also avoid.

This study is also limited to the extent of the available literature on SEZs in Kenya considering it is a new model. The model is fairly new in Kenya having been rolled out after the subsequent failures of the EPZ model. Furthermore, the legal framework only came into being in 2015 and 2016 after the enactment of the SEZ Act, No. 16 of 2015 and the SEZ Regulations of 2016. Data availability on the model in Kenya is therefore still quite scarce.

## **1.10 CHAPTER BREAKDOWN**

Chapter One is the introductory chapter which consists of the background, statement of the problem, justification of the study, objectives, research questions, hypotheses, literature review and limitations of the study.

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<sup>25</sup>Theodore H. Moran , “International Experience with Special Economic Zones (SEZs): Using SEZs to Drive Development in Countries around the World,”(Georgetown University, October 2011)

Chapter Two examines the meaning of the term “SEZ”, its nature and the key features of SEZs. The chapter also delves into the current legal framework governing SEZs in Kenya and investigates the gaps that exist.

Chapter Three focuses on a case study of China which has adopted the SEZ model successfully. It analyses the legal framework governing SEZs in China as well as the strengths and weaknesses of the model in China.

Chapter Four focuses on case studies from Kenya and China which have both adopted the SEZ model. China serves as a good benchmark since it has over the years developed strong bilateral relations with Kenya which continue to yield benefits for both countries economically. This Chapter identifies areas that Kenya can learn from China so as to strengthen this model in the country.

The Fifth and last chapter draws conclusions and makes recommendations that Kenya can adopt in order to benefit from the model and achieve economic liberalization.

## **CHAPTER 2: SEZs IN KENYA AND THE GOVERNING LEGAL FRAMEWORK**

### **2.1 INTRODUCTION**

This chapter seeks to study Kenya's current SEZ legislative framework and examines whether it conforms to best practices around the world. The discussion begins with an examination of the SEZ model and the key features of SEZ framework. Secondly, it examines the current national legislative and regulatory system of SEZ's in Kenya. Thirdly, it identifies some of the loopholes in this system that could result in the failure of this model in the country.

### **2.2 DEFINING THE "SEZ" TERM**

SEZs are geographical areas which have been set aside by the government to offer certain flexible economic policies and tax benefits to firms situated in the zones<sup>26</sup>. Some of these benefits include tax holidays and simplified customs procedures which are not available to the rest of Kenya.<sup>27</sup>

SEZs can operate in three main ways in Kenya. The SEZ can be government sponsored hence making it public. In this particular case, such SEZs are under the national governments control. SEZs can also be private owned where private persons or companies own the zones and invest in them for their profit making capabilities. A good example of this is the Africa Economic Zones in Uasin Gishu County. Finally, a special zone can also operate in Kenya on a public-private basis. In this particular case, the zones are jointly owned by the Government and private firms and its operations are a joint cooperation by both stakeholders.<sup>28</sup>

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<sup>26</sup> Section 4(4) of the Special Economic Zones Act, 2015.

<sup>27</sup> Foreign Investment Advisory Service, "Special economic zones: Performance, lessons learned and implications for zone development" (2008) <<http://documents.worldbank.org/curated/en/343901468330977533/Special-economic-zone-performance-lessons-learned-and-implication-for-zone-development>> accessed on 18<sup>th</sup> November 2017.

<sup>28</sup> Section 4(4) of the Special Economic Zones Act, 2015.

These zones usually have different rules that are applicable compared to the other parts of the economy. The rules ensure that there is ease in doing business in the zones due to flexible economic policies such as tax benefits and simplified customs procedures.<sup>29</sup>The SEZs also enjoy flexible environmental and labour standards, good infrastructure and other policies that attract investors.<sup>30</sup>In some countries where this model has advanced over the years, the SEZs have powers to make their own laws especially those relating to taxes and labour like China.<sup>31</sup>

## **2.3 KEY FEATURES OF SEZs**

The Foreign Investment Advisory Service a department within the World Bank has identified three main characteristics of SEZs in their report on SEZs around the world<sup>32</sup>.

### **2.3.1 Special**

SEZs are considered special as they operate under a different economic and tax regimes compared to the other areas of a country. For an area to be considered a SEZ this features must be present hence making it stand out and attractive to investors.<sup>33</sup>SEZs are also considered special due to the high quality infrastructure present in the zone. The heavily invested infrastructure may be either on roads, railways, airports, water and information technology.<sup>34</sup>The purpose of these amenities is to appeal to investors to set up their firms there.

### **2.3.2 Economic**

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<sup>29</sup>Baissac, C. 2011. Brief history of SEZs and overview of policy debates. In Farole, T. Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience. Washington, DC: World Bank.

<sup>30</sup>Moberg Lotta, "The Political Economy of Special Economic Zones" (2015) Journal of Institutional Economics 13

<sup>31</sup>Ibid 6.

<sup>32</sup> Foreign Investment Advisory Service, "Special economic zones: Performance, lessons learned and implications for zone development" (2008) <<http://documents.worldbank.org/curated/en/343901468330977533/Special-economic-zone-performance-lessons-learned-and-implication-for-zone-development>>accessed on 12<sup>th</sup> July 2019.

<sup>33</sup>T Farole SEZs in Africa: Comparing Performance and Learning from Global Experience(2012) 13.

<sup>34</sup> Ibid.

The second feature of SEZs entails the economic activities undertaken by the firms in the zones. These activities can include manufacturing and information technology. The type of activities done in the zones determines the kind of infrastructure to be invested in such zones.<sup>35</sup>

### **2.3.3 Zone**

The term zone refers to geographical areas which have been set aside by the government to offer certain flexible economic policies and tax benefits to firms situated in the zones<sup>36</sup>. Some of these benefits include tax holidays and simplified customs procedures which are not available to the rest of the economy<sup>37</sup>. However, while the presence of delimited areas is a major requirement, modern SEZs are moving away from actual geographical spaces to purely abstract concepts without the need for tangible locations.<sup>38</sup>

In Kenya, these zones can either be a single sector or a multiple sector<sup>39</sup>. Where a zone is single sector, it is limited to one particular economic activity for example agricultural zones deal purely with agriculture. Multiple sector SEZs undertake two or more economic activities. Multiple sector SEZs are more common in Kenya like Tatu City and Konza City SEZs.<sup>40</sup>

## **2.4 SPECIAL ECONOMIC ZONES IN KENYA**

### **2.4.1 Introduction**

Kenya enacted the Special Economic Zones Act on 5<sup>th</sup> August 2016 which provides for the establishment of SEZs. Thereafter, the SEZ Regulations of 2016 came into force as per Section

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<sup>35</sup>Ibid.

<sup>36</sup> Section 4(4) of the Special Economic Zones Act, 2015.

<sup>37</sup> Ibid.

<sup>38</sup>S Woolfey, Chapter 7, Special Economic Zones and Regional Integration in Africa, Tralac, 111. Chapter in book Cape to Cairo: Exploring the Tripartite FTA Agenda

<sup>39</sup> Section 4(6) of the Special Economic Zones Act, 2015.

<sup>40</sup>Ibid..



39 of the Act.<sup>41</sup> Previously before the shift to SEZs, Kenya had in place the EPZ model which still exists to date. EPZs were created mainly for manufacturing of products to be used for export.<sup>42</sup> However, as noted in a report by the World Bank, this model was unsuccessful on areas such as wealth creation and job creation.

It was further noted that the reasons for the failure of this model was due to wrong timing in setting up this model. This was during the era of globalization of trade investment in the 1980s and 1990s when African countries set up the EPZs model in their jurisdictions during the 1990s and 2000s amid competition by countries which had already successfully implemented the model.<sup>43</sup>

Kenya's EPZ model comprised of units which concentrated on production of single products with limited resources. This made it difficult to produce services and provide the needed infrastructure for use by the whole zone.<sup>44</sup> Furthermore, the EPZ model adopted in Kenya was rigid as it was export-oriented and relied on imported inputs to operate efficiently. Companies in the EPZs were therefore to unable serve the larger East Africa Community market and as a result the model failed to live up to its intended objectives.<sup>45</sup>

The failure of this model is what led the Kenyan to shift to the SEZ model so as to take advantage of its benefits which have been realized in countries like China. Today, there are various SEZs which have been set up in the country as discussed below;

#### **2.4.2 Africa Economic Zones SEZ**

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<sup>41</sup>Section 39 of the Special Economic Zones Act, No.16 of 2015.

<sup>42</sup>Export Processing Zones Authority <<https://epzakenya.com/>>accessed on 12<sup>th</sup> March 2019.

<sup>43</sup>Allan Odhiambo 'Kenya EPZs ranked low on wealth creation' *Business Daily* (Nairobi, 10<sup>th</sup> March, 2016) <https://www.businessdailyafrica.com/markets/Kenya-EPZs-ranked-low-on-wealth-creation-/539552-3111746-4eh6tt/index.html> accessed on 13th March 2019.

<sup>44</sup>Ibid.

<sup>45</sup>Allan Odhiambo 'Kenya EPZs ranked low on wealth creation' *Business Daily* (Nairobi, 10<sup>th</sup> March, 2016) <https://www.businessdailyafrica.com/markets/Kenya-EPZs-ranked-low-on-wealth-creation-/539552-3111746-4eh6tt/index.html> accessed on 13th March 2019.

The Africa Economic Zone SEZ is a 700 acre project operating on a private basis and it is the pioneering SEZ where private persons are the proprietors of the zone.<sup>46</sup> The project is a collaboration between the Chinese and Kenya government. The project came about after the signing of an agreement between Kenya and a China firm known as the Guangdong New South Group during the Belt Road Forum which took place in China.<sup>47</sup>

The geographical advantage of opening up the zone is due to the county's easy access of raw materials.<sup>48</sup> Furthermore the zone is strategically located in a country which will open up the western region of Kenya as well as Uganda. The county has also invested in quality infrastructure such as roads, railways and air transportation together with the presence of numerous institutions of higher learning which are a good source of labour for the zones as well as banks. The project, which will be implemented in four phases in 10 years, is targeted at areas such as medical tourism, wildlife conservation, film industry, entertainment industry, manufacturing sector among others.<sup>49</sup>

### **2.4.3 Tatu City SEZ.**

Tatu City is a five thousand acre project situated in Ruiru, Kiambu County. The project was elevated to the status of an SEZ via a May 22<sup>nd</sup> 2017 gazette notice by the then Industrialisation Cabinet secretary Mr. Adan Mohamed vide a gazette notice number 4892 dated 18<sup>th</sup> May 2017. The project was initially designed as real estate hub with the presence of a large shopping mall before it was elevated to the level of a SEZ.<sup>50</sup>

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<sup>46</sup> Wangilu K, "Chinese firm to construct 200 bn Industrial Park in Eldoret after Beijing deal" (2017) <https://www.nation.co.ke/counties/eldoret/Chinese-firm-to-construct-Sh200b-industrial-park-in-Eldoret/1954186-3932410-hdfu1dz/index.html> accessed on 15<sup>th</sup> May 2018.

<sup>47</sup> Kiganda A., "Chinese firm signs \$ 1.94b deal for construction of Industrial Park in Kenya" *Construction Review Online* (2017) available on <https://constructionreviewonline.com/2017/05/chinese-firm-signs-1-94b-deal-for-construction-of-industrial-park-in-kenya/> accessed on 15<sup>th</sup> May 2018.

<sup>48</sup> Ibid.

<sup>49</sup> Ibid.

<sup>50</sup> Africa Legal Network Legal Alert, 'Special Economic Zones (SEZs): What You Need To Know'(2017) <http://www.africalegalnetwork.com/legal-alert-kenya-special-economic-zones-sezs-need-know/> accessed 21<sup>st</sup> March 2018].

The SEZ has however been affected by corruption in the last number of years. The SEZ model was faced with scandals of tax evasion and money laundering from 2017 and led to Kenya Revenue Authority stopping the sale of land in the SEZ<sup>51</sup>. In this particular case, the Ethics and Anti-Corruption (EACC) asked the Ministry of Lands to provide it with documents touching on transfers, valuation reports, stamp duty receipts, official searches and other land documents relating to various properties in Tatu City. This was necessary in assisting the EACC in investigations of tax evasion and money laundering against the directors of the SEZ. This consequently led to a caveat being placed on the various parcels of land restricting further transactions on the land<sup>52</sup>.

This is one of the challenges that have led to the SEZ not developing to its expected capacity.

#### **2.4.4 Naivasha SEZ**

This SEZ was launched in July 2019 by the Cabinet Secretary after consultation with the SEZ Authority. This SEZ is located in Mai Mahiu area within Nakuru county and is expected to enable various SEZ enterprises within the zone get access to cheap geothermal power from the SEZ<sup>53</sup>. The launching of this SEZ was part of the 9,000 acres of land that were gazetted to operate as SEZs together with other SEZs in Machakos and Mombasa.<sup>54</sup>

#### **2.4.5 Dongo Kundu SEZ**

Dongo Kundu is another SEZ which currently being constructed in Mombasa in collaboration with the Japanese Government. The construction of this SEZ is supposed to take three phases

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<sup>51</sup> Jacob Ngetich, 'Anti-graft Agency moves to probe Tatu City Land' (Nairobi, 13<sup>th</sup> October 2018) <https://www.standardmedia.co.ke/article/2001298936/anti-graft-agency-moves-to-probe-tatu-city-land> accessed on 16th March 2018.

<sup>52</sup> Tatu City Limited & another v Ethics & Anti-Corruption Commission & another [2018] eKLR.

<sup>53</sup> Muriuki J, "Naivasha, Konza City named Special Economic Zones" (2019) <https://www.businessdailyafrica.com/markets/marketnews/Naivasha-Konza-City-named-special-zones/3815534-5213450-c4xsdaz/index.html> accessed on 7/12/2019.

<sup>54</sup> Ibid.

with the first phase of this SEZ expected to be ready by 2023 and create over sixty thousand jobs for the people of the Coast region<sup>55</sup>.

This SEZ is multi-sectoral with various industrial parks, free trade zones, free ports, tourism and recreational zones and residential zones. Some of the benefits that are expected from this project is the creation of over one hundred thousand jobs and bring about four hundred billion Kenya shillings in FDI.<sup>56</sup>

#### **2.4.6 Machakos SEZ**

The launching of this SEZ was part of the 9,000 acres of land that were gazetted to operate as SEZs together with other SEZs in Naivasha and Mombasa.<sup>57</sup> This SEZ is situated in Malili Ranch that hosts Konza city in Makueni County and will occupy 5,000 acres and is expected to operate as an information, communication and technology (ICT) park.<sup>58</sup>

#### **2.4.7 Friendship City SEZ**

Friendship city SEZ is another zone which was proposed in March 2019 for construction in Nairobi's Athi River in collaboration with a Chinese construction company, Beijing Damei Investment Company. This SEZ is expected to bring about job creation of over five hundred

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<sup>55</sup> Wangilu N, "Construction of DongoKundu to start soon," (7<sup>th</sup> December 2019)

<https://www.standardmedia.co.ke/article/2000062436/c.onstruction-of-dongo-kundu-free-port-to-start-soon>>accessed on 5/10/2019.

<sup>56</sup> Otieno D, "Uhuru Launches construction of Dongo Kundu Special Economic zone," (7<sup>th</sup> December 2019 )

<https://www.the-star.co.ke/news/2019-10-18-uhuru-launches-construction-of-dongo-kundu-special-economic-zone/> accessed on 7/12/2019.

<sup>57</sup> Wangui F, "Naivasha, Konza City named Special Economic Zones, (7<sup>th</sup> December 2019)

<https://www.businessdailyafrica.com/markets/marketnews/Naiivasha-Konza-City-named-special-zones/3815534-5213450-c4xsdaz/index.html> >accessed on 7/12/2019.

<sup>58</sup> Ibid.

thousand jobs and an initial FDI of \$2 billion dollars with expected investments of \$7.5 billion dollars when the project is completed.<sup>59</sup>

## **2.5 FACTORS TAKEN INTO ACCOUNT IN SETTING UP OF THE SEZ MODEL IN KENYA**

The following criteria which fall under political, economical and geographical factors are taken into account before an SEZ is set up in a particular area;

### **2.5.1 Land Availability**

This refers to sufficient dimension of the proposed SEZ to support a diverse and competitive business environment. Such land should have ease of identifying interests as well as ease of resolving any potential disputes and claims. Another factor looked into is ability to expand the capacity of the land in the proposed SEZ in the future.<sup>60</sup>

### **2.5.2 Industrial economics and dynamics**

This refers to the presence of business activity and multiple enterprises engaged in formal, registered economic activity within proximity of the boundaries of the proposed special economic zone which could be potential partners of or anchor tenants in the special economic zones.<sup>61</sup>

### **2.5.3 Accessibility and Connectivity Criteria**

This refers to reasonable access to an airport, railway, dry-port, seaport or border post within proximity of the boundaries of the proposed SEZ. Access to adequate labour and consumption markets within proximity of the boundaries of the proposed SEZ is also necessary before setting

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<sup>59</sup> Otieno O., "Kenya partners with China to construct the Friendship city in Nairobi," (3<sup>rd</sup> August 2019) <https://constructionreviewonline.com/2019/03/kenya-partners-with-china-to-construct-the-friendship-city-in-nairobi/> accessed on 5/10/2019.

<sup>60</sup>Section 13(a) of the Special Economic Zones Regulations, 2016.

<sup>61</sup>Section 13(b) of the Special Economic Zones Regulations, 2016.

up an SEZ. Distribution centres for semi-finished inputs and exports must also be within proximity of the boundaries of the proposed SEZ.<sup>62</sup>

#### **2.5.4 Infrastructure criteria**

Infrastructure plays a vital role in ensuring that operations in SEZs run smoothly as well as opening up the firms to their targeted markets. The CS looks into resources such as fresh surface water and access to waste water treatment and sewerage within reasonable proximity of the proposed special economic zone. Good roads, social infrastructure like schools, hospitals, hotels, retail business, and places of worship must also be within the proximity of the proposed SEZ. Another key factor that is considered is suitable distance of proposed special SEZ assets from dangerous infrastructure to prevent losses or likelihood of accidents.<sup>63</sup>

#### **2.5.5 Socio-Environmental Criteria**

Socio-environmental criteria looked into by the CS includes suitable climate, absence of flooding risk to the proposed SEZ site .It also includes adequate security, presence of significant religious, cultural, or similar assets that can be properly integrated into the special economic zones planning, absence of any significant health risks. The ability to relocate population in a socio-economically acceptable manner if the proposed SEZ would involve population displacement as well as to relocate agricultural, commercial or other industrial activities in a cost-effective manner is also considered.<sup>64</sup>

#### **2.5.6 Topographical and Construction Constraints**

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<sup>62</sup>Section 13(c) of the Special Economic Zones Regulations,2016.

<sup>63</sup>Section 13(d)of the Special Economic Zones Regulations,2016.

<sup>64</sup>Section 13(e)of the Special Economic Zones Regulations,2016.

This refers to the physical features of an area. The CS is required to consider factors such as level and grading, soil conditions, erosion conditions, soil contamination and other construction constraints in the proposed SEZ.<sup>65</sup>

### **2.5.7 Development impact potential<sup>66</sup>**

The CS is required to look into the developmental impact of establishing an SEZ in the proposed site. This includes establishing whether the proposed SEZ will improve the quality of life for lower-income populations and produce positive social and economic spillover effects outside the proposed zones<sup>67</sup>. The CS also ensures that the proposed zones positively influence regional or national infrastructure planning as well as coherence with other development projects in the area and land-use master plans.<sup>68</sup>

Economic factors such as increased economic diversification, national employment generation, increased wages and working standards of the workforce in the zones are also considered by the CS.<sup>69</sup> Other important factors include skills-development and training of workforce that will be required in the zones. The government therefore uses both the orthodox and heterodox approaches earlier discussed when evaluating the economic development brought about by these zones.

## **2.6 THE CURRENT SEZ LEGISLATIVE FRAMEWORK**

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<sup>65</sup>Section 13(f) of the Special Economic Zones Regulations, 2016.

<sup>66</sup>Section 13(g) of the Special Economic Zones Regulations, 2016.

<sup>67</sup>Section 13(g) (i) of the Special Economic Zone Regulations, 2016.

<sup>68</sup>Section 13(g) (iv) of the Special Economic Zone Regulations, 2016.

<sup>69</sup>Section 13(g) (ix) of the Special Economic Zone Regulations, 2016.

Kenya has enacted the SEZ Act of 2015 (the “Act”)<sup>70</sup> which started operating from 15<sup>th</sup> March, 2015. In addition to this Act, Kenya has also enacted the SEZ Regulations of 2016 which are a subsidiary legislation to the Act.<sup>71</sup> Apart from these two main legislations, there are other legislations governing the SEZ model in Kenya as contained in relevant provisions of the various statutes.

### **2.6.1 THE SEZ ACT, 2015**

In Kenya, SEZs are defined as geographical areas set aside by the government to offer certain flexible economic policies and tax benefits to firms situated in the zones.<sup>72</sup> Some of these benefits include tax holidays and simplified customs procedures which are not available to the rest of Kenya.<sup>73</sup> This legislation was formulated with the aim of drawing in foreign investments through the provision of incentives such as infrastructure and tax benefits which consequently led to the creation of a conducive business environment for investors.<sup>74</sup>

#### **2.6.1.1 Establishment of an SEZ**

Kenya’s SEZs can only exist where geographical areas are authorised to operate as such by the CS for Industrialization.<sup>75</sup>

#### **2.6.1.2 Institutional Framework**

The Ministry of Industry, Trade and Cooperatives headed by the CS, Hon. Peter Munya is tasked with the development of the SEZs in Kenya. SEZs in Kenya are governed by the Special

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<sup>70</sup>Special Economic Zones Act, No. 16 of 2015.

<sup>71</sup>Special Economic Zones Regulations, 2016.

<sup>72</sup> Section 4(4) of the Special Economic Zones Act, 2015.

<sup>73</sup> Section 4(5) of the Special Economic Zones Act, 2015.

<sup>74</sup> Section 3(a) of the Special Economic Zones Act, 2015.

<sup>75</sup>Section 4 of the Special Economic Zones Act, 2015.



Economic Zones Authority (SEZA) under the leadership of a board of directors which is headed by chairperson after Presidential approval.<sup>76</sup>

The SEZA is tasked with the following functions<sup>77</sup>;

#### **2.6.1.2.1 Operational role**

The Administrative Committees are tasked with formulating plans for developing the zones and implementing them. They also determine which investors should be allowed to operate in the zones<sup>78</sup>. In doing this, the Authority identifies the areas which can be declared as SEZs.<sup>79</sup>The Authority also reviews applications and grants licenses to SEZ developers and maintains a register of enterprises and residents who have been approved to be in the zones<sup>80</sup>.

#### **2.6.1.2.2 Implementation role**

In this role, the Authority undertakes the development of appropriate infrastructure within the zones such as proper road networks, hospitals, provision of electricity and water and such other necessities required for the proper functioning of the zones<sup>81</sup>.

#### **2.6.1.2.3 Marketing Role**

The Authority is tasked with advertising the zones to potential investors by making them seem attractive based on the incentives offered in the zones. In doing this, the Authority works in conjunction with the Ministry of Industry, Trade and Cooperatives in holding various trade fairs,

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<sup>76</sup>Section 12 of the Special Economic Zones Act, 2015.

<sup>77</sup>Section 11 Special Economic Zones Act of 2015.

<sup>78</sup> Section 11(a) of the Special Economic Zones Act,2015.

<sup>79</sup> Section 11(c) of the Special Economic Zones Act,2015.

<sup>80</sup> Section 11(f) of the Special Economic Zones Act,2015.

<sup>81</sup> Section 11(e) of the Special Economic Zones Act,2015.

conferences and stakeholder meetings where the SEZs concept is marketed to potential investors<sup>82</sup>.

#### **2.6.1.2.4 Administrative role**

There are various services are offered by these zones to potential investors. The Act in promoting efficiency when investors are being served makes provision for all services to be availed under one roof<sup>83</sup>. These services include issuing of work visas and permits, facilitating labour reporting obligations, registration of SEZs, licensing, and evaluation of proposals to designate areas as SEZs amongst other functions.<sup>84</sup> These all service shops play a vital role in preventing time wastage or inconvenience to the potential investors by having to go to different areas to get different services.

The Authority is also tasked with monitoring the activities of the firms within the zones. This is important as it ensures that the zones are performing to full capacity and bringing about positive impact in that area.<sup>85</sup> It is also required to establish strong links with various stakeholders who play key roles in the SEZ model operations.<sup>86</sup> The National Environment Management Authority (NEMA) is one such state agency that ensures that all activities done within these zones do not cause harmful effects to the environment.

#### **2.6.1.2.5 Regulatory Role**

The Authority ensures that only licensed firms can operate in the zones.<sup>87</sup> It also regulates and supervises all aspects of the zones. In doing so, the Authority advises the CS on some of the

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<sup>82</sup> Section 11(g) of the Special Economic Zones Act, 2015.

<sup>83</sup> One stop shops.

<sup>84</sup> Section 31(1) of the Special Economic Zones Regulations, 2016.

<sup>85</sup> Section 11(j) of the Special Economic Zones Act, 2015.

<sup>86</sup> Section 11 (k) of the Special Economic Zones Act, 2015.

<sup>87</sup> Section 11 (n) of the Special Economic Zones Act, 2015.

economic activities banned within the zones.<sup>88</sup> For example, the Authority can recommend to the CS to cancel licenses of firms whose activities are detrimental to the environment.<sup>89</sup>

### **2.6.1.3 Application for a SEZ License**

Only licensed firms can operate in the zones.<sup>90</sup> In order to obtain a license, a firm is required to make an application to the SEZ Authority. Thereafter the firm is required to pay the necessary fee imposed under the Act. The Authority gives feedback within 30 days of receiving the application whether the firm can set up shop in the zones.<sup>91</sup>

The Act provides that certain requirements must be met for a firm to be eligible to operate in Kenya. Firstly, the company must have been formed in Kenya with the sole objective of running as SEZs. Secondly, the firm must prove it is financially able to operate the zone. Thirdly, the firm must be capable of purchasing or leasing land in the zones.<sup>92</sup>

### **2.6.1.2 Trading in SEZ goods and services**

Just like the earlier EPZ economic model, goods and services produced in a SEZ are eligible for sale outside Kenya. The goods can also be vended in Kenya under the same conditions required of imports.<sup>93</sup>

## **2.6.2 BENEFITS UNDER THE SEZ ACT**

### **2.6.2.1 Tax Benefits**

Firms operating within the zones are exempted from paying taxes under all local laws and regulations. These Acts include<sup>94</sup>;

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<sup>88</sup> Section 11 (l) of the Special Economic Zones Act, 2015.  
<sup>89</sup> Section 11 (m) of the Special Economic Zones Act, 2015.  
<sup>90</sup> Section 27 of the Special Economic Zones Act, 2015.  
<sup>91</sup> Section 27 of the Special Economic Zones Act, 2015.  
<sup>92</sup> Section 28 of the Special Economic Zones Act, 2015.  
<sup>93</sup> Section 6 of the Special Economic Zones Act, 2015.

### **2.6.2.1.1 Finance Act,2017**

Under the Finance Act No. 15 of 2017 withholding tax is not payable for any dividends paid by SEZs to any non-resident.<sup>95</sup>The Act also sets fees for professional services, managerial work, training and royalties' fees payable by a SEZ enterprise at a tax rate of 5% while interest payable by a SEZ to a non-resident is subjected to 5% withholding tax.<sup>96</sup>Another incentive under this Act is 100 percent tax exemption on capital expenditure of an SEZ.<sup>97</sup>

In effect, the above amendments were therefore necessary to bring about consistency with the SEZ Act which offers unlimited exemption on all taxes.

### **2.6.2.1.2 Stamp Duty Act, 2012**

Stamp duty is one of the taxes that has been exempted in the SEZ Act and the Stamp duty Act, This Act expressly provides that an instrument which relates to business activities of SEZ firms is not susceptible to stamp duty.<sup>98</sup>Payment of stamp duty by firms within SEZs exemptions is also prohibited provided by the Finance Act, 2018<sup>99</sup>.

### **2.6.2.1.3 Foreign Investments and Protection Act,2017**

Foreign investments in Kenya are regulated by this Act. This Act aims to attract foreign investments into the country. This Act offers tax exemptions more so relating to certificates for approved enterprises within the Act. This Act provides that a foreigner who wishes to invest foreign assets in Kenya must apply to the relevant Minister to be granted a certificate to operate

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<sup>94</sup>Section 35(2) of the Special Economic Zones Act,2015.

<sup>95</sup> Section 15 of the Finance Act,No. 15 of 2017.

<sup>96</sup>Section 18 (c) of the Finance Act No. 15 of 2017.

<sup>97</sup>Section 17 of the Finance Act,No. 15 of 2017 provides for a 100 percent investment tax deduction in the first year of use of capital expenditure by a SEZ enterprise during the construction of a building or on the purchase and installation of machinery for use by the enterprise in carrying out its business.

<sup>98</sup>Section 117(n) of the Stamp Duty Act, Cap 480.

<sup>99</sup> Section 62 of the Finance Act,2018.

in the country<sup>100</sup>. However with this tax exemption, the foreigners investing in SEZs are not liable to pay taxes when applying for such certificates.

#### **2.6.2.1.4 Alcoholic Drinks Control Act, 2010**

This Act provides that a person intending to manufacture or produce any alcoholic drinks or operate an establishment selling alcoholic drinks must make an application to the County Committee in order to be granted either a general liquor licence or a hotel liquor licence<sup>101</sup>. The SEZ Act ensures that firms within SEZs are not susceptible to pay tax in order to be granted a general liquor licence or a hotel liquor licence.

#### **2.6.2.1.5 Tea Act, 2012**

The Tea Act provides that for a person to manufacture tea in Kenya one requires a license.<sup>102</sup> The SEZ Act ensures that firms within SEZs are not susceptible to pay tax taxes and duties that are levied in order to be granted a tea manufacturing license.

#### **2.6.2.1.6 Films and Stages Plays Act, 2012**

The Films and Stages Plays Act provides that no film shall be made in Kenya for public exhibition or sale within Kenya or outside Kenya without licence issued by a licensing officer under the Act<sup>103</sup>. The SEZ Act ensures that firms within SEZs are not susceptible to pay tax in order to acquire a filming license under this Act.

#### **2.6.2.2 Provision of work permits**

All licensed firms in the zones are availed to work permits which cater up to twenty percent of their full-time employees. Extra work permits can be granted to firms with the permission of the

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<sup>100</sup>Section 3 of the Foreign Investments and Protection Act.

<sup>101</sup>Section 9 of the Alcoholic Drinks Control Act, 2010.

<sup>102</sup>Section 13 of the Tea Act, Cap 343.

<sup>103</sup>Section 4 of the Films and Stages Plays Act.

SEZ Authority. These extra permits are however only available to designated special industries.

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### **2.6.2.3 Other Incentives**

The Finance Act, 2017 has also introduced various operational benefits applicable to firms within the zones.<sup>105</sup>

Preferential withholding tax rates on payments to non-resident persons are provided by the Third Schedule of the ITA. Management and professional fees have been reduced from 20 percent to 5 percent, interests from 15 percent to 5 percent and royalty from 20 percent to 5 percent.

### **2.6.3 RIGHTS OF SEZ ENTERPRISES**

Under the Act, a licensed SEZ firms shall enjoy the following rights<sup>106</sup>;

#### **2.6.3.1 Right against expropriation**

All licensed SEZ firms enjoy the right of expropriation. This right ensures that they are not deprived of their property by the Kenyan government for public use. The SEZ Act protects foreign investors by ensuring that their investments are well protected hence encouraging more investors to join the SEZ model.<sup>107</sup>

#### **2.6.3.2 Right of repatriation of capital and profits**

Repatriation of capital and profits to the foreign investors gives them assurance that they will get back their investments from the host country.<sup>108</sup>This in turn encourages foreign investors to invest in host countries which have high repatriation rates. A country like China for example

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<sup>104</sup> Section 35 (3) of the Special Economic Zones Act,2015.

<sup>105</sup> Section 18 (c) of the Finance Act,2017.

<sup>106</sup>Section 35 of the Special Economic Zones Act,2015.

<sup>107</sup>Section 34(a) of the Special Economic Zones Act,2015.

<sup>108</sup> Section 34(b) of the Special Economic Zones Act, 2015.

allows foreign investors to repatriate up to 90 percent of their annual profits provided certain conditions are met.<sup>109</sup>

### **2.6.3.3 Rights of protection of Intellectual property rights**

SEZ firms enjoy the right of protection intellectual property rights, in particular trademarks, patents, copyrights industrial designs and technical processes. Such protection promotes innovation hence creating a favorable climate for FDI as it assures investors of protection of their economic investments in host countries.<sup>110</sup>

### **2.6.3.4 Right to enter into contracts**

All licensed SEZ firms enjoy the right to contract with other enterprises. This refers to rights extend to activities such as buying, selling, leasing, or transferring land or buildings in the SEZs.<sup>111</sup>

### **2.6.3.5 Right to transact**

All licensed SEZ firms enjoy the right to export and import goods and services<sup>112</sup>. This right also extends to transacting and carrying out business with enterprises that are not situated within the SEZ zones.<sup>113</sup>

## **2.6.4 DISPUTE RESOLUTION**

The SEZ Act has laid out the manner of resolution of disputes within the zones. Disputes can be solved by way of negotiations and mutual agreement between the parties. Where parties fail to reach an understanding, arbitration is resulted to.<sup>114</sup>The arbitration procedure in this case is

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<sup>109</sup>Profit repatriation: The Foreign Direct Investment Incentive available at <https://wealthhow.com/profit-repatriation-foreign-direct-investment-incentive>>accessed on 25/9/2019).

<sup>110</sup> Section 34(c ) of the Special Economic Zones Act,2015.

<sup>111</sup> Section 34(g) of the Special Economic Zones Act,2015.

<sup>112</sup>Section 34(d) of the Special Economic Zones Act,2015.

<sup>113</sup> Section 34(f) of the Special Economic Zones Act,2015.

<sup>114</sup> Section 37 of the Special Economic Zones Act,2015.

guided by the law of international commercial arbitration.<sup>115</sup> However in the case of failure to reach a resolution within 14 days by the procedures set out in the law of international commercial arbitration, the Arbitration Act of Kenya will apply.<sup>116</sup>

## **2.7 THE SPECIAL ECONOMIC ZONES REGULATIONS, 2016 (L.N. NO. 147 OF 2016)**

These Regulations implement provisions of the SEZ Act and concern the designation and administration of SEZs. They contain provisions on matters such as environmental impact assessment, land use planning, sustainable development and prohibition as well monitoring of activities within designated zones. Where a person wishes for the designation of a particular area as a SEZ, they can submit a proposal to the Special Economic Zones Authority for consideration.<sup>117</sup>

### **2.7.1 GAZETTING OF SEZs**

The Regulations provide that any person may submit a proposal to the SEZA for designation of an area as an SEZ<sup>118</sup>. Such a proposal should be accompanied by a feasibility study report which contains a market-demand analysis, an economic impact assessment, a strategic environmental and social-impact assessment and any other information that may be required by the Authority.<sup>119</sup>

The SEZA reviews the proposal within thirty days and thereafter recommends to the Cabinet Secretary whether such an area can be designated as a SEZ<sup>120</sup>. The Authority can either reject or approve the recommendation.<sup>121</sup>

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<sup>115</sup>Section 37 2(a) of the Special Economic Zones Act,2015.

<sup>116</sup>Section 37(3) of the Special Economic Zones Act,2015.

<sup>117</sup>Special Economic Zones Regulations,2016.

<sup>118</sup>Section 10 of the Special Economic Zones Regulations,2016.

<sup>119</sup>Section 11 of the Special Economic Zones Regulations,2016.

<sup>120</sup> Section 10(2) of the Special Economic Zones Regulations,2016.

<sup>121</sup>Section 12(1) of the Special Economic Zones Regulations,2016



## **2.7.2 CRITERIA FOR EVALUATION**

The Cabinet Secretary (CS) can designate an area as a SEZ if it meets the following conditions;

### **2.7.2.1 Land Availability**

This refers to sufficient dimension of the proposed SEZ to support a diverse and competitive business environment. Such land should have ease of identifying interests as well as ease of resolving any potential disputes and claims. Another factor looked into is ability to expand the capacity of the land in the proposed SEZ in the future.<sup>122</sup>

### **2.7.2.2 Industrial economics and dynamics**

This refers to the presence of business activity and multiple enterprises engaged in formal, registered economic activity within proximity of the boundaries of the proposed special economic zone which could be potential partners of or anchor tenants in the special economic zones.<sup>123</sup>

### **2.7.2.3 Accessibility and Connectivity Criteria**

This refers to reasonable access to an airport, railway, dry-port, seaport or border post within proximity of the boundaries of the proposed SEZ. Access to adequate labour and consumption markets within proximity of the boundaries of the proposed SEZ is also necessary before setting up an SEZ. Distribution centers for semi-finished inputs and exports must also be within proximity of the boundaries of the proposed SEZ.<sup>124</sup>

### **2.7.2.4 Infrastructure criteria**

Infrastructure plays a vital role in ensuring that operations in SEZs run smoothly as well as opening up the firms to their targeted markets. The CS looks into resources such as fresh surface

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<sup>122</sup>Section 13(a) of the Special Economic Zones Regulations,2016.

<sup>123</sup>Section 13(b) of the Special Economic Zones Regulations,2016.

<sup>124</sup>Section 13(c) of the Special Economic Zones Regulations,2016.

water and access to waste water treatment and sewerage within reasonable proximity of the proposed special economic zone. Good roads, social infrastructure like schools, hospitals, hotels, retail business, and places of worship must also be within the proximity of the proposed SEZ. Another key factor that is considered is suitable distance of proposed special SEZ assets from dangerous infrastructure to prevent losses or likelihood of accidents.<sup>125</sup>

#### **2.7.2.5 Socio-Environmental Criteria**

Socio-environmental criteria looked into by the CS includes suitable climate, absence of flooding risk to the proposed SEZ site .It also includes adequate security, presence of significant religious, cultural, or similar assets that can be properly integrated into the special economic zones planning, absence of any significant health risks. The ability to relocate population in a socio-economically acceptable manner if the proposed SEZ would involve population displacement as well as to relocate agricultural, commercial or other industrial activities in a cost-effective manner is also considered.<sup>126</sup>

#### **2.7.2.6 Topographical and Construction Constraints**

This refers to the physical features of an area. The CS is required to consider factors such as level and grading, soil conditions ,erosion conditions, soil contamination and other construction constraints in the proposed SEZ.<sup>127</sup>

#### **2.7.2.7 Development impact potential<sup>128</sup>**

The CS is required to look into the developmental impact of establishing an SEZ in the proposed site. This includes establishing whether the proposed SEZ will improve the quality of life for lower-income populations and produce positive social and economic spillover effects outside the

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<sup>125</sup>Section 13(d)of the Special Economic Zones Regulations,2016.

<sup>126</sup>Section 13(e)of the Special Economic Zones Regulations,2016.

<sup>127</sup>Section 13(f) of the Special Economic Zones Regulations,2016.

<sup>128</sup>Section 13(g) of the Special Economic Zones Regulations,2016.

proposed zones<sup>129</sup>.The CS also ensures that the proposed zones positively influence regional or national infrastructure planning as well as coherence with other development projects in the area and land-use master plans.<sup>130</sup>

Economic factors such as increased economic diversification, national employment generation, increased wages and working standards of the workforce in the zones are also considered by the CS.<sup>131</sup>Other important factors include skills-development and training of workforce that will be required in the zones. The government therefore uses both the orthodox and heterodox approaches earlier discussed when evaluating the economic development brought about by these zones.

### **2.7.3 LICENSING**

For an SEZ to operate, the developers and operators must conclude an agreement with SEZA. The Authority can only issue a license to such an operator in accordance with the Act. The agreements can either be operator agreements or developer agreements<sup>132</sup>.There is no limit on the number of SEZs or licenses issued for a SEZ enterprise<sup>133</sup>.Upon conclusion of these agreements, licensing fees should be paid to the Authority as specified<sup>134</sup>.

The Authority has to ensure that technical health or safety requirements as prescribed by the Authority in accordance with international standards, except that different or more stringent standards may be imposed where the Authority is certain, for reasons relating to the special

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<sup>129</sup> Section 13(g) (i) of the Special Economic Zone Regulations,2016.

<sup>130</sup> Section 13(g) (iv) of the Special Economic Zone Regulations,2016.

<sup>131</sup>Section 13(g) (ix) of the Special Economic Zone Regulations,2016.

<sup>132</sup>Section 19 of the Special Economic Zones Regulations,2016

<sup>133</sup>Section 26(2)of the Special Economic Zones Regulations,2016

<sup>134</sup>Section 21(1) of the Special Economic Zones Regulations,2016.

economic zone's specific physical, social, economic, or cultural characteristics or context, that such standards do not fulfil the required level of protection.<sup>135</sup>

Policy requirements must be met by the SEZ operators and developers as they are necessary for the protection of public health, national or public security, labour, safety, and culture and consumer protection. The Authority is also tasked with ensuring that environmental protection requirements are complied with by the SEZ operators. This is done through the applicant's environmental impact statement as provided in these Regulations and the relevant environmental laws.<sup>136</sup>

#### **2.7.4 LAND USE RULES**

The SEZA has the role in ensuring that land use master plans submitted by applicants do not conflict with existing land use regulations for areas surrounding the SEZs or related objectives of the neighbouring county governments<sup>137</sup>.

The Regulations prevent activities which may lead to the emission of any substance beyond specified thresholds into water, air, or land as noise above the specified decibel limits set by the Authority for particular areas<sup>138</sup>. The Regulations also prohibit intensive exploitation of natural resources over *de minimis* levels prescribed by the Authority for particular resources. Activities which may cause nuisance affecting the ability of SEZ end users or persons outside the SEZ to enjoy or use their property are also prohibited by the Regulations. The same applies to activities which may contribute to ozone depletion or global warming over *de minimis* levels prescribed by the Authority.<sup>139</sup>

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<sup>135</sup>Section 27 of the Special Economic Zones Regulations,2016.

<sup>136</sup> Section 27(c) of the Special Economic Zones Regulations,2016.

<sup>137</sup>Section 38(2) of the Special Economic Zones Regulations,2016.

<sup>138</sup> Section 41 (1) (a) of the Special Economic Zones Regulations,2016.

<sup>139</sup>Section 41(1) (e) of the Special Economic Zones Regulations,2016.

## **2.8 Shortcomings of the current system**

The current SEZ framework of Kenya has various shortcomings that need to be properly addressed.

### **2.8.1 Non- Implementation of the law**

Otiato Guguyu examines the various legal issues which arise in the current legal framework governing SEZs in Kenya. One such issue is the arbitrariness behind how the SEZ's are created. He questions in particular the criteria used to set up these zones especially when these zones are used by politicians for political leverage during election periods.<sup>140</sup> While the Act does provide for the criteria for evaluation before designating an area as a SEZ with factors such as infrastructure, politicians have undermined the SEZ Authority by promising the public the establishment of SEZs in their regions as tool to get votes during election periods<sup>141</sup>. Such declarations must be avoided as the function of determining the establishment of an SEZ belongs to the SEZ Authority.

### **2.8.2 Revenue leakage**

Where the formation of SEZs is politically motivated, they tend to be used as tools of political leverage during electioneering periods.<sup>142</sup> The problem is that such SEZs are devoid of the proper requirements provided for under the law. One good example is the case of Tatu City SEZ. When the city was elevated to the level of a SEZ back in 2017, the firms which had already set up their operations there automatically began to enjoy the rights of SEZ firms without any vetting if they had conformed to the requirements under the SEZ Act, 2015.

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<sup>140</sup>Otiato Guguyu and Macharia Kamau, 'Is Kenya overbanking on new Special Economic Zones to drive growth?' (Nairobi, July 25<sup>th</sup> 2017)2

<sup>141</sup>Section 13 of the Special Economic Zones Act, No. 16 of 2015.

<sup>142</sup> Ibid.

Where such zones are established without following the proper criteria, it can lead to numerous instances where companies evade paying taxes by creating subsidiaries in the SEZ's which can consequently lead to the loss of income for the country.<sup>143</sup> This has consequently led to revenue leakage that was also experienced with the EPZs.<sup>144</sup> Proper vetting of companies is therefore necessary by the SEZA authority especially where subsidiary companies are concerned.

### **2.8.3 Corruption**

Corruption has been at the centre of many failed development projects in Kenya. Corruption tends to kill economies as it prevents investors from setting up shops in countries where it is rampant. This is mainly due to the fact it requires firms to pay bribes as to obtain licences and other incentives hence taking away from their profits.<sup>145</sup>

Tatu City for example was faced with scandals of tax evasion and money laundering from 2017. This subsequently led to Kenya Revenue Authority stopping the sale of land in the SEZ.<sup>146</sup> In this particular case, the Ethics and Anti-Corruption (EACC) asked the Ministry of Lands to provide it with documents touching on transfers, valuation reports, stamp duty receipts, official searches and other land documents relating to various properties in Tatu City. This was necessary in assisting the EACC in investigations of tax evasion and money laundering against the directors of the SEZ. This consequently led to a caveat being placed on the various parcels of land restricting further transactions on the land.<sup>147</sup>

### **2.8.4 Lack of Institutional Autonomy**

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<sup>143</sup>Otiato Guguyu and Macharia Kamau, 'Is Kenya overbanking on new Special Economic Zones to drive growth?' (Nairobi, July 25<sup>th</sup> 2017)2

<sup>144</sup> Ibid.

<sup>145</sup>Moberg Lotta, "The Political Economy of Special Economic Zones" (2015) *Journal of Institutional Economics* 22.

<sup>146</sup>Jacob Ngetich, "Anti-graft Agency moves to probe Tatu City Land " (13<sup>th</sup> October 2018)

<https://www.standardmedia.co.ke/article/2001298936/anti-graft-agency-moves-to-probe-tatu-city-land> accessed on 16th March 2018.

<sup>147</sup>Tatu City Limited & another v Ethics & Anti-Corruption Commission & another [2018] eKLR.

SEZs in Kenya do not have the autonomy to make laws governing their operations. The overall administration of all the SEZs is left in the hands of the SEZA which is an organ of the centralized government. There is need for decentralization of power to authorities located within these zones which best understand the economic policies that should be put in place.

The Chinese SEZs for example have legislative authority to make their own laws. This autonomy enables them to formulate policies and other economic measures which are important in their operations.<sup>148</sup> The SEZs in Kenya would benefit if such an approach is taken as they would put in place laws that are specific to their conditions. For example an SEZ located in Mombasa has different laws and policies it should pursue compared to an SEZ located in Eldoret due to their economic, topographical, cultural, climatic and infrastructural differences.

## **2.9 CONCLUSION**

This chapter has evaluated the legislative and institutional framework governing SEZs in Kenya. While the country recently developed an overarching SEZ legal framework, the framework is tainted with weaknesses and gaps that need to be properly addressed. It should however be noted that although the new framework may facilitate the economic growth of the country and bring about FDI when adhered to, the challenges still remain. The chapter is thus concluded by noting that effective enforcement of the legislative framework governing SEZs in Kenya is very crucial in the realization of the benefits of this model.

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<sup>148</sup>Wang, Jin. 2013. "The economic impact of Special Economic Zones: Evidence from Chinese municipalities", *Journal of Development Economics*, Volume 101, 2013, pp133 – 147.

## **CHAPTER 3: SPECIAL ECONOMIC ZONES IN CHINA**

### **3.1 INTRODUCTION**

This chapter focuses on the SEZ regime in China so as to draw lessons for Kenya in the last chapter of this study. The chapter undertakes an in-depth evaluation of China's SEZ's and their legislative framework and reveals the underlying successes and weaknesses of the model. This is crucial as this Chapter will form a basis of whether Kenya can benefit from the experiences of China which may be regarded as the most successful implementer of this model worldwide.

Chinese SEZ's have existed since the late 1970's.<sup>149</sup> The success of these zones has provided a blueprint on how best to implement this model by the rest of the world. In some regions in China, these zones account for 50% to 80 or 90% of growth in GDP.<sup>150</sup> Over the years, Kenya and China have engaged in bilateral trade which has resulted in collaborations on various SEZs like the African Economic Zones and Friendship City situated in Kenya. It is due to these reasons that Kenya should draw valuable lessons from China on how best to implement this model which is relatively new in Kenya.

### **3.2 THE SEZs MODEL IN CHINA**

In the recent years, SEZs have become a popular tool for economic development throughout the world. SEZ concepts also continue to change as they become popularized in developing countries.<sup>151</sup> The basic concept of an SEZ refers to a geographical area which has been set aside by the government and is governed by flexible economic and tax regimes compared to the rest of the economy.<sup>152</sup>

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<sup>149</sup>Yuan, Yiming, et al. 2009. "China's First Special Economic Zones: The Case of Shenzhen". A background study for the World Bank.

<sup>150</sup> Ibid.

<sup>151</sup>Farole, T., 'Special economic zones in Africa: Comparing performance and learning from global experience', World Bank, 2011.

<sup>152</sup>World Bank. 2009. "Clusters for Competitiveness: A Practical Guide and Policy Implications for Developing Cluster Initiatives," International Trade Department, PREM Network, Report, World Bank, Washington, DC.



The first four SEZ's were established in China in 1980 following implementation of the open policy by China which aimed to expose the country to other parts of the world through the promotion of trade. These zones were namely, Shenzhen, Shantou, Zhuhai and Xiamen. These zones main objective was to promote economic development in China. The zones were strategically located in Guangdong and Fujian due to their proximity to Hong Kong in which China has considerable political and economic interest in.<sup>153</sup>

The main objective of these zones was to bring about economic liberalization for China through increased FDI.<sup>154</sup> Shenzhen is today the most successful SEZ transforming itself from a fishing village also known for sales of counterfeit products to a thriving business hub.<sup>155</sup> Today, Shenzhen is one of China's richest cities.<sup>156</sup>

### **3.3FACTORS TAKEN INTO ACCOUNT IN SETTING UP THE SEZ MODEL IN CHINA**

#### **3.3.1 ECONOMIC FACTORS**

The Chinese government adopted the open policy in late 1970's and as a consequence of this approach, the SEZ model was formulated to enable the country achieve economic liberalization. The SEZ's were encouraged to adopt economic policies that would enable China open its boundaries to the world and engage in trade. The SEZ model if successful would be adopted by the rest of China.<sup>157</sup>

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<sup>153</sup>Wong, Kwanyiu. 1987. "China's Special Economic Zone Experiment: An Appraisal." *Geografiska Annaler Serices B, Human Geography* 69 (1): 27–40.

<sup>154</sup>Yeh, Gar-On Antony. "Development of the Special Economic Zone in Shenzhen, The People's Republic of China." *Ekistics*, vol. 52, no. 311, 1985, pp. 154–161.

<sup>155</sup>Ibid.

<sup>156</sup>Mack, Lauren "Special Economic Zones in China." ThoughtCo, Feb.4,2019, [thoughtco.com/chinas-special-economic-zones-sez-687417](https://www.thoughtco.com/chinas-special-economic-zones-sez-687417).

<sup>157</sup>Dahlman, Carl, Douglas Zhihua Zeng, and Shuilin Wang. 2007 *Enhancing China's Competitiveness through Lifelong Learning*. Washington, DC: World Bank.

### 3.3.2 GEOGRAPHICAL FACTORS

The initial SEZs set up in China were located Guangdong and Fujian provinces.<sup>158</sup> The reasons for this were to limit political interference from cities such as Beijing, opening up the zones to Taiwan and Hong Kong, availability of labour and technology as well as good infrastructure.<sup>159</sup> The choice of Shenzhen was especially due to its accessibility to the port of Hong Kong and potential investors from that region.<sup>160</sup>

### 3.3.3 POLITICAL FACTORS

China's SEZs are modelled along prevention of political influence in the zones by locating them away from centres of political influence like Beijing.<sup>161</sup> The central government has decentralized its power to avoid undermining the SEZs. At the same time, the municipal governments have autonomy to make laws that are specific to their geographical locations.

There were various political considerations taken into account during the setting up of these zones. First, the zones needed to be easily delimited from the rest of China's territory as drastic different policies were to be implemented in the zones.<sup>162</sup> All four SEZs are located along the coast, which made physical separation from the inland areas easier. Second, the SEZ's were not invested heavily in by the government to prevent drastic losses if the model failed to succeed.<sup>163</sup>

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<sup>158</sup>E Knoth 'Special Economic Zones and Economic Transformation the Case of the People's Republic of China' Unpublished PhD thesis, University of Konstanz, 2000 25.

<sup>159</sup> Ibid.

<sup>160</sup>Yeung, Yue-man, J. Lee, and G. Kee, 'China's Special Economic Zones at 30.' Eurasian Geography and Economics(2009) 50 (2): 222–40.

<sup>161</sup>DZ Zeng 'Global experiences with special economic zones with a focus on China and Africa'(2015) 4.

<sup>162</sup>Wong, Kwan-yiu. 1987. "China's Special Economic Zone Experiment: An Appraisal." *Geografiska Annaler Series B, Human Geography* 69 (1): 27–40.

<sup>163</sup> Ibid.

Last, the central government wanted to use the zones to attract the Chinese community living overseas in countries like Hong Kong so as to bring them back to inland China.<sup>164</sup>

### **3.4 SPECIAL ECONOMIC ZONES IN CHINA**

#### **3. 4.1 SHENZHEN SEZ**

Shenzhen was declared a SEZ in 1980 and it is currently located in Guangdong Province. The zone was originally a fishing village and a hub for counterfeit products. The zone is among the earliest SEZs formed in China.<sup>165</sup>

Shenzhen is regarded as China's most successful SEZ. One factor for the success is related to income taxes. The income tax rates are lower than the rest of the surrounding regions which has attracted many firms to set up in the SEZ<sup>166</sup>. The land use policy in the zone has also played a big part in its success as the land in the zone is easily accessible to foreign investors at very low costs.<sup>167</sup> It is due to these policies that Shenzhen has attracted a large part of China's total FDI making it an important tool for China's economic development.<sup>168</sup>

#### **3.4.2 SHANTOU SPECIAL ECONOMIC ZONE**

The SEZ is located in Guangdong between Hong Kong and Taiwan. Due to its ideal foundation in the port economy and its special geographical location, Shantou was selected as one of the SEZ's in 1980.<sup>169</sup>

The success of this SEZ can be attributed to three main factors<sup>170</sup>;

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<sup>164</sup>Yeung, Yue-man, J. Lee, and G. Kee. 2009. "China's Special Economic Zones at 30." *Eurasian Geography and Economics* 50 (2): 222–40

<sup>165</sup>Guo Zhemin. On the basis of setting up special economic zones [J]. *China's economic problems*, 1984, (05): 1-7

<sup>166</sup>Ann Fenwick, *Evaluating China's Special Economic Zones*, 2 *Int'l Tax & Bus. Law.* (1984).

<sup>167</sup>S Woolfrey 'Special economic zones and regional integration in Africa' (2013) 125.

<sup>168</sup>Wong, Kwan-yiu. 1987. "China's Special Economic Zone Experiment: An Appraisal." *Geografiska Annaler Serices B, Human Geography* 69 (1): 27–40

<sup>169</sup>He Chunlin. Special Economic Zone: ten years of exploration and development [J]. *Lookout weekly*, 1990, (35): 4-5.

1. Shantou SEZ's zones enjoy duty-free for export goods and tax reduction for imports.
2. The SEZ enjoys cheap labour resources from the surrounding areas.
3. Shantou also enjoys quality infrastructure such as an airport, railways, ports and higher education institutions.

Over time, the infrastructure in the zone continues to improve, the economy has kept growing, people's living standards and health standards have also significantly improved which demonstrates the role of the heterodox and orthodox approaches to economic development. Shantou is a key economic hub that has played a major role in China's economic liberalization and its importance cannot be underestimated.<sup>171</sup>

### **3.4.3 ZHUHAI SEZ**

The Zhuhai SEZ is situated in Guangdong province. The SEZ is comprised mainly of mechanical and electronics industries.<sup>172</sup> The SEZ also operates other industries such as pharmaceuticals and other industrial chemicals. Zhuhai also enjoys quality infrastructure with major highways such as the Guangzhou-Shenzhen-Zhuhai superhighway and the Zhuhai Airport which play a major role in transportation of products to and fro.<sup>173</sup>

### **3.4.4 XIAMEN SEZ**

This seaport is situated in Fujian Province and is known to be a popular tourist destination in China.<sup>174</sup> The Xiamen SEZ was officially declared an SEZ in 1981. The zone is easily accessible

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<sup>170</sup>Wang Yue. Some problems that must be paid attention to in the establishment and development of special economic zones (economic development zones) [J]. Reform and strategy, 1985, (02): 4-8.

<sup>171</sup> Ibid.

<sup>172</sup>Yi Quan. WTO and the future of China's Special Economic Zone [J]. SEZ economy, 2001, (05): 20-22

<sup>173</sup>Joseph Fewsmith, 1986, "Special Economic Zones of PRC," Communistic Issue, Vol.35, No. 6

<sup>174</sup>GuoZhemin. On the basis of setting up special economic zones [J]. China's economic problems, 1984, (05): 1-7

as it enjoys quality infrastructure such as air, railways and a roads. A good example of this is the Gaoqi Airport which caters to international flights.<sup>175</sup>

Xiamen has been able to export its products to all over the world in countries in Asia and also the west such as USA and the European region.<sup>176</sup>Xiamen's GDP continues to grow immensely as the zone acts as an important hub for China's economic development.<sup>177</sup>

### **3.5 LEGAL FRAMEWORK ON THE SEZ MODEL IN CHINA**

In July 1979, during China's post-Mao reorientation towards rapid economic modernization, the Chinese Communist Party permitted the provinces of Guangdong and Fujian to operate under different economic and tax regimes from the rest of China.<sup>178</sup>This directive led to the setting up of four SEZs in the two provinces.<sup>179</sup>However, after this directive there was no legal framework in place to guide foreigners interested in investing in the zones. This led to the formulation of the Regulations on SEZs in Guangdong Province and the enactment of various regulations governing SEZs in Fujian province.

Discussed below are some of the major regulations in Guangdong and Fujian Provinces which cater to the four main SEZs.

#### **3.5.1 THE 1980 REGULATIONS ON SEZs IN GUANGDONG PROVINCE.**

The Guangdong regulations are considered the centerpiece of China SEZs. These regulations only govern only Guangdong's three SEZ's that is, Shenzhen, Zhuhai, and Shantou. These regulations grant powers to the Administrative Commission to determine which investments are permitted in

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<sup>175</sup>Huang Mengping, Gong Jie. Research on construction planning and development of Xiamen Special Administrative Region [J].Future and development, 1982.

<sup>176</sup>New trend of China's five special economic zones [J]. Inner Mongolia propaganda, 1992, (24): 30-32.

<sup>177</sup> People Daily, "Historical Background about Xiamen Special Economic Zone" (2017)

<http://en.people.cn/90002/95607/6529564.html> accessed on 11th May 2018.

<sup>178</sup>Ann Fenwick, *Evaluating China's Special Economic Zones*, 2 Int'l Tax & Bus.Law. 376 (1984)

<sup>179</sup>Ibid .

the zones<sup>180</sup>. The SEZ Administrative Commissions play a major role in the administration of these zones. The Administrative Commissions are tasked with functions such as ensuring that the SEZs are administered in accordance to the law; determining which investment projects are to be set up in the zones; allocation of land amongst others.<sup>181</sup>

The Regulations are divided into 6 main chapters. Discussed below are some of the issues that are contained in these regulations;

### **3.5.1.1 Establishment of SEZs in Guangdong Province**

The regulations provide for the setting up of three SEZs in Shenzhen, Zhuhai and Shantou cities in Guangdong Province.<sup>182</sup> These regulations provide for the formation of Guangdong Provincial Administrative Commission and go further to lay out the authorized economic activities within these zones.<sup>183</sup>

### **3.5.1.2 Registration of SEZs in Guangdong Province**

The regulations empower the Administrative Commission to vet application forms by investors before they can set up their firms.<sup>184</sup> On approval of the application forms, investors are then issued with registration certificates as proof that they can operate within the zones<sup>185</sup>.

### **3.5.1.3 Preferential Treatment in the zones**

The zones enjoy various fiscal and non-fiscal incentives. Some of the incentives include quality infrastructure, exemption of both export and import duties, simple exit and entry procedures for

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<sup>180</sup>A Fenwick 'Evaluating China's special economic zones'(1984) 376 Berkeley Journal of International Law 376

<sup>181</sup>E Knoch 'Special Economic Zones and Economic Transformation the Case of the People's Republic of China' Unpublished PhD thesis, University of Konstanz, 2000 25.

<sup>182</sup>Article 1 of the Regulations.

<sup>183</sup>Article 4 of the Regulations.

<sup>184</sup>Article 7 of the Regulations.

<sup>185</sup>Article 8 of the Regulations.

the foreigners entering and leaving the zones.<sup>186</sup> Investors are also able to benefit from income tax exemptions if they put back their profits to the zones for five years or longer.<sup>187</sup>

#### **3.5.1.4 Labour Relations in the zones**

The regulations empower the zones to administer the workforce in the zones.<sup>188</sup> The Regulations further grant the zones power over their workforce in determining the wages payable and also protect the workers from exploitation.<sup>189</sup> Provision of insurance is another key feature of these regulations which ensure that employers take out insurance for their employees in case of injuries sustained during work hours<sup>190</sup>.

#### **3.5.1.5 Operation of the zones**

The Guangdong Committee is in charge of the everyday operations of the zones. Some of its duties entail approval of application forms, registration of enterprises, maintaining law and order, establishing public welfare institutions, providing the labour force, protecting workers interests and coordinating various stakeholders in the zones such as telecommunications, banking and customs.<sup>191</sup>

### **3.6 THE REGULATIONSON SEZs IN FUJIAN PROVINCE**

The Xiamen SEZ was established in October 1980.<sup>192</sup> Just like the case in Guangdong province, the SEZs located in Fujian province also have the legal mandate to formulate laws that govern themselves. Some of the Regulations governing Xiamen SEZ are discussed below;

#### **3.6.1 The 1984 Regulations on Labor Management in the Xiamen SEZ**

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<sup>186</sup> Article 13 of the Regulations

<sup>187</sup> Article 16 of the Regulations.

<sup>188</sup> Article 20 of the Regulations

<sup>189</sup> Article 21 of the Regulations.

<sup>190</sup> Article 22 of the Regulations.

<sup>191</sup> Article 23 of the Regulations.

<sup>192</sup> Huang Mengping, Gong Jie. Research on construction planning and development of Xiamen Special Administrative Region [J].Future and development, 1982.

These regulations empower SEZ enterprises to formulate their labour laws and report to the Xiamen City Bureau of Labor for the record. The regulations further prohibit minors from working in the zones. Any minor working there is required to get necessary approvals from Xiamen City Bureau of Labour.<sup>193</sup>

The Regulations further grant the SEZs powers over their workforce in determining the wages payable and protect the workers from exploitation.<sup>194</sup> Provision of insurance is another key feature of these regulations which ensure that employers take out insurance for their employees in case of injuries sustained during work hours.<sup>195</sup>

### **3.6.2 The 1984 Regulations on the Administration of the Registration of Enterprises in Xiamen SEZ**

These Regulations provide guidelines which enterprises must adhere to in order to operate in Xiamen SEZ. Any person or firm wishing to operate in the zone is required to register with a body known Xiamen Municipal Industry and Commerce Administration Bureau. Failure to follow the correct registration procedures automatically disqualifies a firm from operating in Xiamen.<sup>196</sup>

Any person or firm wishing to operate in the zone is required to obtain approval of the zones local government which issues the licenses'.<sup>197</sup> In applying for registration, persons or companies are expected to fill the proper forms in which one of the forms must be in the Chinese language.<sup>198</sup> The Regulations also confer power to the Xiamen Municipal Industry and

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<sup>193</sup> Article 4 of the Regulations.

<sup>194</sup> Article 7 of the Regulations.

<sup>195</sup> Ibid.

<sup>196</sup> Article 2 of the Regulations.

<sup>197</sup> Article 3 of the Regulations.

<sup>198</sup> Article 4 of the Regulations



Commerce Administration Bureau which performs similar roles to the SEZ Authority in Kenya in monitoring the zones and ensuring that they are operating within the confines of the law.<sup>199</sup>

### **3.7 INSTITUTIONAL FRAMEWORK ON THE SEZ MODEL IN CHINA**

The provincial governments in China are tasked with the development of the SEZs: Guangdong province for Shenzhen, Shantou for Zhuhai and Fujian province for Xiamen<sup>200</sup>. The Administrative Committees which fall under these provincial governments are tasked with running the operations of the zones.<sup>201</sup>

These Committees are tasked with various functions which can be split into two main categories;<sup>202</sup>

#### **3.7.1 Administrative roles**

The Administrative Committees are tasked with formulating plans for developing the zones and implementing them. They also determine which investors should be allowed to operate in the zones.<sup>203</sup> In doing this, the Committees ensure that the activities being undertaken in the zones are not harmful to the environment and also prevent illegal activities from being performed within the zones.

The Administrative Committees are also tasked with issuing of licenses to the SEZ enterprises. Once this has been done, the committees register the new investors in their databases. Another role of the committees is ensuring that the zones work effectively with the relevant stakeholders

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<sup>199</sup> Article 13 of the Regulations

<sup>200</sup> Ibid.

<sup>201</sup> Ibid.

<sup>202</sup> Article 23 of the 1980 Regulations on Special Economic Zones in Guangdong Province.

<sup>203</sup> Article 23(3) of the Regulations on Special Economic Zones in Guangdong Province.

within the zones like banks.<sup>204</sup> This ensures that the SEZs receive the necessary services for them to operate efficiently.

### **3.7.2 Operational roles**

The Administrative Committees have a duty to provide the enterprises in the zones with labour force as well as protecting the labour rights of the staff members and workers<sup>205</sup>. This ensures that the employees are not exploited by their employers and subjected to inhumane working conditions.

The Administrative Committees are also concerned about the social welfare of those working and residing within these zones. These committees also play a regulatory role by ensuring that zones operate within confines of the law.<sup>206</sup>

## **3.8 REASONS FOR THE SUCCESSES OF THE SEZ MODEL IN CHINA**

### **3.8.1 Open policy environment**

China has put in place the open door policy which allows foreign countries to trade with it in an equal platform.<sup>207</sup>

This has been the significant factor behind the robust growth of the SEZ model in China. This policy has resulted in the strengthening of links between China and other parts of the world in

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<sup>204</sup> Article 23(4) of the Regulations on Special Economic Zones in Guangdong Province.

<sup>205</sup> Article 23(5) of the Regulations on Special Economic Zones in Guangdong Province.

<sup>206</sup> Article 23(7) of the Regulations on Special Economic Zones in Guangdong Province.

<sup>207</sup> Ge, Wei. 1999. "Special Economic Zones and the Opening of the Chinese Economy: Some Lessons for Economic Liberalization." *World Development* 27 (7): 1267–85.

terms of trade. In Africa for example, China has partnered with various countries and has gone further to develop overseas investments which in turn create foreign income for China.<sup>208</sup>

### **3.8.2 Availability of quality infrastructure**

Quality infrastructure such as harbors, airports, roads and telecommunication networks are important for economic activities to flourish. SEZs like Xiamen are strategically situated near the major airports and railways to ease in the movement of goods and services. Quality infrastructure enables the zones to carry out their activities smoothly without time wastage. China has over the years made invested heavily in infrastructure especially within these special zones.<sup>209</sup>

### **3.8.3 Adequate SEZs' financing environment**

Financing of SEZ's in China is plentiful, easily available and efficiently allocated. This is one of the ways that the central government has provided support for these zones. Presence of adequate funding plays a vital role in enabling the zones to have the necessary incentives and capacity in their day to day operations. Without such funding there is likelihood of the operations of the zones being grounded which could have devastating effects on the economy.<sup>210</sup>

### **3.8.4 Advantageous geographical locations**

The SEZ's in China have greatly benefitted from their geographical locations. Most of the SEZs are strategically located in areas which provide the necessary incentives for the zones. Xiamen SEZ for instance is located near airports, major roads and railways. Another good example of

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<sup>208</sup>Yuan Y. et.al. 2010. "China's First Economic Zone: The Case of Shenzhen –Building Engines for Growth and Competitiveness in China", Washington, DC: The World Bank.

<sup>209</sup>Zeng, D.Z. 2010. Building Engines for Growth and Competitiveness in China. Policy Report no. 56447, The World Bank, Washington DC.

<sup>210</sup>ProLogis. 2008. "China's Special Economic Zones and National Industrial Parks Door Openers to Economic Reform." ProLogis Research Bulletin (Spring).

this are the special zones in Guangdong provinces located along the coastline or near major cities with links to the international market and investors like Hong Kong.<sup>211</sup>

### **3.8.5 Lack of political or government interference**

The SEZ's in China were situated far from major cities such as Beijing to avoid interference by the national government. Interference by the central government would result to the operations of the zones being hampered as they would be susceptible to government control in their day to day running. By being situated far away, the zones were able to determine what was in their best interests independently from the national government.<sup>212</sup>

### **3.8.6 Preferential Policies and Institutional Autonomy**

In order to attract investors, the SEZ's have put in place preferential policies for example tax holidays and rapid customs clearance. Furthermore, the SEZ's are given political and economy autonomy to develop laws and economic policies provided that they do not deviate from what is acceptable under the national laws. These are key factors that have led to the growth of the zones.<sup>213</sup>

### **3.8.7 Government Support**

Government support has led to the success of this model in China. The central government by decentralizing its powers and conferring autonomy on the SEZs to make their own laws has helped create a conducive environment for the growth of the zones. The central government has

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<sup>211</sup>Zeng, D.Z. 2010. Building Engines for Growth and Competitiveness in China. Policy Report no. 56447, The World Bank, Washington DC

<sup>212</sup> Ibid.

<sup>213</sup>Enright, Michael J., Edith Scott, and Ka-mun Chung. 2005. Regional Powerhouse: The Greater Pearl River Delta and the Rise of China. Singapore: John Wiley & Sons (Asia).

also provided good infrastructure to the zones which includes roads, railways, airports, provision of electricity and water which play an important role in the operations of the zones.<sup>214</sup>

### **3.9 CHALLENGES OF THE SEZ MODEL IN CHINA**

#### **3.9.1 The decline in preferential policies**

When the SEZs were first established, they were considered “special” as they enjoyed favourable economic and tax policies compared to the rest of China. However, over time these policies advanced to other parts of China hence losing the special aspect of these zones. The main cause of this turn of events was China joining the World Trade Organisation in 1992 where these preferential policies were now applicable uniformly to the entire country.<sup>215</sup>

#### **3.9.2 The homogeneity problem**

Over the years, many SEZs in China have been engaging in provision of similar goods and services. The lack of differentiation of products and services has resulted to public resources being wasted as the Chinese government funds these zones. It is therefore advisable for these zones to concentrate on different sectors to curb the wastage and provide a variety of products to the Chinese market.<sup>216</sup>

### **4.0 CONCLUSION**

This chapter has examined China’s legislative and institutional framework on the SEZ model. The model has been able to achieve economic liberalization for China and the country is today the most successful implementer of the special zones.<sup>217</sup> The zones have played an important role

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<sup>214</sup>Zheng, Yu. 2009. “Incentives and Commitment: The Political Economy of Special Zones in China. “Unpublished. University of Connecticut, Storrs, CT.

<sup>215</sup>Zhang, Chunlin, Douglas Zihua Zeng, William Mako, and James Seward. 2009. Promoting Enterprise-led Innovation in China. Washington, DC: World Bank.

<sup>216</sup> Ibid.

<sup>217</sup>Feng, Yang, Examining the Legislation in China's Special Economic Zones: Framework, Practice and Prospects (November 1, 2017).

in reforming the Chinese economy through the myriad benefits the model has to offer.<sup>218</sup> By borrowing from the implementation of this model in China and how its legislative framework has been structured, Kenya is likely to succeed in the same.

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<sup>218</sup>Harold Jerome Gross, 'China's Special Economic Zones' (1987) 4 China Law Reporter 23  
<<https://heinonline.org/HOL/Page?handle=hein.journals/china4&id=199&div=&collection=>>.

## **CHAPTER 4: AN ECONOMIC ANALYSIS ON THE IMPLEMENTATION OF THE SEZ MODEL IN KENYA AND CHINA**

### **4.1 INTRODUCTION**

The previous chapter has discussed how the Chinese government has put into effect the SEZ model within its territory. The Chapter has looked in the legislative framework as well as the factors that have led to the successes as well as the challenges that face the model in China.

China's success with the SEZ model has led to economic transformations in the country. The SEZs have brought about the development of new technologies, innovation, high employment rates, increase in exports and foreign investments in China.<sup>219</sup> Kenya has on the other hand just recently embraced the SEZ model after subsequent failures of the EPZ model. Various SEZs have been set up in Kenya the most notable being Tatu city in Kiambu County which has been at the center of corruption in the recent years.

This study will delve into an economic analysis of the implementation of this model in China and Kenya. While this model is fairly new in Kenya, there are some implementation challenges that exist which need to be addressed. The following section of this study will discuss the implementation of the SEZ model in Kenya in contrast to China.

### **4.2 LEGAL FRAMEWORK**

In July 1979, during China's post-Mao reorientation toward rapid economic modernization, the Chinese Communist Party permitted the provinces of Guangdong and Fujian to operate under different economic and tax regimes from the rest of China.<sup>220</sup> This directive led to the setting up of four SEZs in the two provinces.<sup>221</sup> However, after this directive there was no legal framework

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<sup>219</sup>Ibid.

<sup>220</sup>Ann Fenwick, *Evaluating China's Special Economic Zones*, 2 Int'l Tax & Bus.Law. 376 (1984)

<sup>221</sup>Ibid 376.

in place to guide foreigners interested in investing in the zones. This led to the formulation of the Regulations on SEZs in Guangdong Province and the enactment of various regulations governing SEZs in Fujian province as was discussed earlier in the paper.<sup>222</sup>

One important feature to note is that while the Guangdong zones and Fujian zones are subject to China's laws, these Regulations are only applicable to the zones and not the rest of the country. Secondly, these laws are enacted by the provincial governments in which the SEZs are located. This means SEZs in China have legislative authority to develop regulations and amend them according to the economic needs of these zones.<sup>223</sup>

In Kenya, however, the SEZs do not have authority to enact laws that is specific to their locations. This limits the formulation of laws that are favourable to the economic potential of these zones. Another weakness in the Kenyan legal framework is that the Act<sup>224</sup> and Regulations<sup>225</sup> apply uniformly to all the SEZs in Kenya notwithstanding the fact that these zones are located in different regions with different economic, geographic ,infrastructural and climatic conditions.

Furthermore, the Chinese legal framework is such that the zonal governments have enacted regulations which deal with specific issues. For example, as discussed earlier in the paper, Fujian Province has enacted regulations on labour and administrative issues. In Kenya however, the Act and Regulations are assumed to cater for all the issues that may arise in the SEZs established in Kenya.

### **4.3 INSTITUTIONAL FRAMEWORK**

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<sup>222</sup>CD Stoltenberg 'China's special economic zones: Their development and prospect's(1983) 24 Asian Survey639

<sup>223</sup>Oluwaseyi A ( n 53 above) 75.

<sup>224</sup>Special Economic Zones Act,No. 16 of 2015.

<sup>225</sup>Special Economic Regulations,2016.



The provincial governments in China are tasked with the development of the SEZs: Guangdong province for Shenzhen, Shantou for Zhuhai and Fujian province for Xiamen<sup>226</sup>. The Administrative Committees which fall under these provincial governments are tasked with running the operations of the zones..<sup>227</sup>

These Committees are tasked with various functions which can be split into two main categories;<sup>228</sup>

#### **4.3.1 Administrative roles**

The Administrative Committees are tasked with formulating plans for developing the zones and implementing them. They also determine which investors should be allowed to operate in the zones.<sup>229</sup> In doing this, the Committees ensure that the activities being undertaken in the zones are not harmful to the environment and also prevent illegal activities from being performed within the zones.

The Administrative Committees are also tasked with issuing of licenses to the SEZ enterprises. Once this has been done, the committees register the new investors in their databases. Another role of the committees is ensuring that the zones work effectively with the relevant stakeholders within the zones like banks.<sup>230</sup> This ensures that the SEZs receive the necessary services for them to operate efficiently.

#### **4.3.2 Operational roles**

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<sup>226</sup>Ibid.

<sup>227</sup> Ibid.

<sup>228</sup>Article 23 of the Regulations on Special Economic Zones in Guangdong Province.

<sup>229</sup>Article 23(3) of the Regulations on Special Economic Zones in Guangdong Province.

<sup>230</sup>Article 23(4) of the Regulations on Special Economic Zones in Guangdong Province.

The Administrative Committees have a duty to provide the enterprises in the zones with labour force as well as protecting the labour rights of the staff members and workers<sup>231</sup>. This ensures that the employees are not exploited by their employers and subjected to inhumane working conditions.

The Administrative Committees are also concerned about the social welfare of those working and residing within these zones. They do this by establishing educational, cultural, health and various social welfare institutions in the zones.<sup>232</sup> These committees also play a regulatory role by ensuring that zones operate within confines of the law.<sup>233</sup>

In Kenya on the other hand, the Ministry of Industry, Trade and Cooperatives is in charge of regulating the establishment of SEZ's while the SEZ Authority is tasked with issuing licences to firms to operate in the zones.<sup>234</sup> The SEZA is tasked with various functions as provided in Section 11 of the Special Economic Zones Act.<sup>235</sup> The SEZA and the Administrative Committees perform various similar tasks such as determining the investment criteria in the zones and granting licences to SEZ developers. However, one of the weaknesses which arises between the Administrative committees and SEZA is that the Administrative Committees in China have been bestowed more powers in crucial matters that may arise in the SEZs like labour issues.

These Committees have functions like protecting the labour rights of workers working in the SEZs.<sup>236</sup> The Institutional framework in Kenya however does not deal with such matters and as a result various violations of labour rights can take place like child labour and mistreatment of the workers. It is important to note that a poor working condition of the workers was one of the failures of the EPZ model in Kenya. Some of the complaints included low salaries, employees

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<sup>231</sup> Article 23(5) of the Regulations on Special Economic Zones in Guangdong Province.

<sup>232</sup> Article 23(6) of the Regulations on Special Economic Zones in Guangdong Province.

<sup>233</sup> Article 23(7) of the Regulations on Special Economic Zones in Guangdong Province.

<sup>234</sup> Section 10, Special Economic Zones Act No. 16 of 2015.

<sup>235</sup> Section 11, Special Economic Zones Act No. 16 of 2015.

<sup>236</sup> Article 23 of the 1980 Regulations on Special Economic Zones in Guangdong Province.

were expected to work overtime without commensurate pay and not all employees had access to protective clothing even when the work they performed exposed them to hazards among others.

#### **4.4 INCENTIVES**

There are various incentives put in place in the Chinese SEZ's to attract FDI which include amongst others; no customs duties; good infrastructure; tax holidays; flexible labour laws; work permits and residences for foreigners working in the SEZs.<sup>237</sup>

Kenya has also introduced various incentives which accrue to investors in the zones like tax exemptions which were discussed in Chapter two.<sup>238</sup> Section 35 of the SEZ Act exempts all licensed investors in the zones from paying taxes under various legislations.<sup>239</sup> The SEZ Act further makes provision for work permits to foreign investors looking to invest in Kenya's SEZs.<sup>240</sup>

In China, various tax benefits are offered to a manufacturing company during the beginning of its operations. The firms are completely exempted from paying tax during the years they are starting up and are yet to receive any profits. In China, corporate income taxes are also reduced in comparison to areas outside the zones while products in the zones are exempted from import and export duties.<sup>241</sup>

The Kenyan government therefore needs to put in place more attractive incentives to encourage foreign investment in these zones like China.

#### **4.5 STRATEGIC GEOGRAPHICAL LOCATIONS**

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<sup>237</sup>T Xiao yang 'How do Chinese 'special economic zones' support economic transformation in Africa'(2015) 3.

<sup>238</sup>Section 35,Special Economic Zones Act,2015.

<sup>239</sup> Section 35 of the Act exempts SEZs enterprises, developers and operators from all taxes and duties payable under the Excise Duty Act, the Income Tax Act, East African Community Customs Management Act and the Value Added Tax Act, on all SEZ transactions.

<sup>240</sup>Section 35 (3) Special Economic Zones Act,2015.

<sup>241</sup>Yuan Y. et.al. 2010. "China's First Economic Zone: The Case of Shenzhen –Building Engines for Growth and Competitiveness in China", Washington, DC: The World Bank. Export and import tax exemptions are available to equipment, raw materials, and office supplies in Chinese SEZs.

The initial SEZs set up in China were located Guangdong and Fujian provinces.<sup>242</sup>The reason for this was to limit political interference from cities such as Beijing, opening up the zones to Taiwan and Hong Kong, availability of labour and technology as well as good infrastructure.<sup>243</sup>The choice of Shenzhen was especially due to its accessibility to the port of Hong Kong and potential investors from that region.<sup>244</sup>

The SEZ Act provides for the criteria of designating SEZs and identifies various factors like geographical location and infrastructure.<sup>245</sup> However, some of the SEZs initially set up in Kenya were due to election promises by politicians. As a result, these SEZ's were developed without taking into consideration their economic potential and consequently led to wastage of public resources.<sup>246</sup>

#### **4.6 GOVERNMENT SUPPORT**

China's SEZs are modelled along prevention of political influence in the zones by locating them away from centres of political influence like Beijing.<sup>247</sup>The central government has decentralized its power to avoid undermining the SEZs. At the same time, the municipal governments have autonomy to make laws that are specific to their geographical locations. However in Kenya, the SEZ development agenda is sometimes influenced by politics.<sup>248</sup> For example during the 2017

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<sup>242</sup>E Knoth 'Special Economic Zones and Economic Transformation the Case of the People's Republic of China' Unpublished PhD thesis, University of Konstanz, 2000 25.

<sup>243</sup> Ibid.

<sup>244</sup>Yeung, Yue-man, J. Lee, and G. Kee, 'China's Special Economic Zones at 30.' *Eurasian Geography and Economics*(2009) 50 (2): 222–40.

<sup>245</sup>Section 5, Special Economic Zones Act No. 16 of 2015.

<sup>246</sup>Guguyu O. 'Is Kenya Overbanking on new Special Economic Zones to drive Growth?' *The Standard* (2017) available on <https://www.standardmedia.co.ke/business/article/2001249043/is-kenya-overbanking-on-new-special-economic-zones-to-drive-growth> accessed on 15th May 2018.

<sup>247</sup>DZ Zeng 'Global experiences with special economic zones with a focus on China and Africa'(2015) 4.

<sup>248</sup>Guguyu O n 262.

election year period, various regions were promised by politicians the establishment of SEZs as a campaign manifesto which undermines the role of the SEZ Authority.<sup>249</sup>

#### **4.7 TRANSPARENCY AND INTEGRITY**

Corruption is one of the factors that lead to failure of SEZs in any economy. Where a firm has to pay bribes in order to acquire various permits to set up an SEZ, this increases the chances that it must pay more in bribes than it makes in profits<sup>250</sup>. With such practices, SEZs can become a vehicle for corruption which makes the system unpredictable for investors. This can eventually kill economic growth in the country which has been the case with Tatu City.

Tatu City was faced with scandals of tax evasion in 2018 and led to Kenya Revenue Authority stopping the sale of land in the zone.<sup>251</sup> Corruption in Kenya thus makes it impossible for investors to set up businesses in the country. China has embraced a strict policy towards corruption and introduced the death penalty as the ultimate deterrent for those found guilty of this offence.<sup>252</sup> This law has seen various government officials prosecuted for this offence. Kenya needs to follow in the footsteps of China and embrace stricter laws for corruption and go further to prosecute the culprits regardless of their social or political status.

#### **4.8 FAVOURABLE ECONOMIC POLICIES**

The SEZs in China have the powers to make and amend laws governing these zones<sup>253</sup>. Furthermore, China developed the open door policy in which it granted equal trade

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<sup>249</sup> Ibid.

<sup>250</sup> Moberg Lotta, “The Political Economy of Special Economic Zones” (2015) *Journal of Institutional Economics* 22.

<sup>251</sup> Jacob Ngetich, ‘Anti-graft Agency moves to probe Tatu City Land’ (Nairobi, 13<sup>th</sup> October 2018) <https://www.standardmedia.co.ke/article/2001298936/anti-graft-agency-moves-to-probe-tatu-city-land> accessed on 16<sup>th</sup> March 2018.

<sup>252</sup> Moberg Lotta, “The Political Economy of Special Economic Zones” (2015) *Journal of Institutional Economics* 22

<sup>253</sup> K Wong ‘China's special economic zone experiment: An appraisal’ (1987) 69 *Swedish Society for Anthropology and Geography* 35.

opportunities to all countries<sup>254</sup>.Kenya is yet to adopt an open door policy with all countries like China .However opening up the country to citizens of the East African Community to work in Kenya without work permits is a positive stride towards achieving economic liberalization. The government still needs to do more and formulate better economic policies to expose Kenya as an investment hub to potential investors.

#### **4.9 GOVERNMENT AUTONOMY**

Unlike China, SEZs in Kenya do not have the mandate to administer the enterprises which are located in their jurisdictions. In Kenya, the administration of all the SEZs is left in the hands of the SEZA which is an organ of the centralized government. The Chinese have understood that the SEZs should be located away from political influence like Beijing for the model to be successful.<sup>255</sup>In a politically centralized system therefore, the SEZ model is likely to be implemented successfully as the local governments are well informed about which economic policies they should pursue that are specific to the needs of their locations.<sup>256</sup>

#### **5.0 CONCLUSION**

The SEZ model which was pioneered by the PRC continues to benefit the country in a myriad of ways. China has benefited through increased foreign exports, increased FDI as well as immense employment opportunities for its locals. Although the concept is fairly new in Kenya, the country can benefit immensely by emulating China and learning from its mistakes during the conception of the model. Much remains to be done in Kenya for the model to reap the gains that the PRC has been able to achieve over the years.

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<sup>254</sup>DZ Zeng ‘China and Africa’s experiences with special economic zones: What can we learn (2014) 3.

<sup>255</sup>Moberg Lotta, “The Political Economy of Special Economic Zones” (2015) *Journal of Institutional Economics* 22.

<sup>256</sup>Ann Fenwick, *Evaluating China's Special Economic Zones*, 2 *Int'l Tax & Bus.Law*.376 (1984).

## CHAPTER 5: SUMMARY OF FINDINGS: CONCLUSION AND RECOMMENDATIONS

### 5.1 INTRODUCTION

This paper focuses on the SEZ model in Kenya as well as in China. It examines the legal and institutional framework of the SEZ model in both countries. It also identifies the gaps and challenges that exist in Kenya's model and even in the Chinese model. This chapter goes further to make recommendations on the lessons that Kenya can learn from China on implementing the model successfully in its jurisdiction.

China's SEZs have played an important role in the country's economic development. Foremost, SEZs in China especially Shenzhen, Zhuhai, Shantou, Xiamen have provided a template that is today used by other parts of China and the world.<sup>257</sup> The zones have also led to increased rates of employment, poverty alleviation, skills development, technology transfer, increased exports, and increased FDI in China.<sup>258</sup> These zones have made significant contributions to the economy of China and it is today considered the most successful country in the implementation of the SEZ model.

Vision 2030 provides Kenya with a blueprint to becoming an industrialized country by the year 2030.<sup>259</sup> SEZs as a tool for economic development are becoming popular in Kenya with various zones being set up across the country in recent years. This is well addressed in the country's current Medium Term Plans III (2018 – 2022).<sup>260</sup> The SEZ model is fairly new in Kenya following the legislation of laws such as the SEZ Act in 2015 and its regulations in 2016. The EPZs were in operation in Kenya previously but the model experienced significant challenges which made it necessary to shift to the SEZ model so as to reap benefits for example tax benefits

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<sup>257</sup>ProLogis. "China's Special Economic Zones and National Industrial Parks—Door Opener to Economic Reform." ProLogis Research Bulletin (Spring) 2008.

<sup>258</sup>Ann Fenwick, *Evaluating China's Special Economic Zones*, 2 Int'l Tax & Bus. Law. 376 (1984).

<sup>259</sup>Government of the Republic of Kenya *Second Medium-Term Plan: Transforming Kenya*. Nairobi (2013).

<sup>260</sup>Ibid.

for investors and elimination of impediments in doing business in the zones such as high taxes and complex exist and entry procedures.<sup>261</sup>

Kenya enacted the Special Economic Zones Act on 5<sup>th</sup> August 2016 which provides for the establishment of SEZs. Thereafter, the SEZ Regulations of 2016 came into force as per Section 39 of the Act.<sup>262</sup> Previously before the shift to SEZs, Kenya had in place the EPZ model which still exists to date. EPZs were created mainly for manufacturing of products to be used for export.<sup>263</sup> However, as noted in a report by the World Bank, this model was unsuccessful on areas such as wealth creation and job creation.

It was further noted that the reasons for the failure of this model was due to wrong timing in setting up this model. This was during the era of globalization of trade investment in the 1980s and 1990s when African countries set up the EPZs model in their jurisdictions during the 1990s and 2000s amid competition by countries which had already successfully implemented the model.<sup>264</sup>

Kenya's EPZ model comprised of units which concentrated on production of single products with limited resources. This made it difficult to produce services and provide the needed infrastructure for use by the whole zone.<sup>265</sup> Furthermore, the EPZ model adopted in Kenya was rigid as it was export-oriented and relied on imported inputs to operate efficiently. Companies in

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<sup>261</sup>International Journal of Innovation and Economics Development, vol. 4, issue 4, pp. 32-46, October 2018

<sup>262</sup>Section 39 of the Special Economic Zones Act, No.16 of 2015.

<sup>263</sup>Export Processing Zones Authority <<https://epzakenya.com/>>accessed on 12<sup>th</sup> March 2019.

<sup>264</sup>Allan Adhiambo 'Kenya EPZS ranked low on wealth creation' *Business Daily* (Nairobi,10<sup>th</sup> March,2016) <https://www.businessdailyafrica.com/markets/Kenya-EPZs-ranked-low-on-wealth-creation-/539552-3111746-4eh6tt/index.html>accessed on 13th March 2019.

<sup>265</sup>Ibid.



the EPZs were therefore to unable serve the larger East Africa Community market and as a result the model failed to live up to its intended objectives.<sup>266</sup>

It was due to this challenges that led the government to roll out the SEZ model to address the weaknesses of the EPZ model as well as to improve Kenya's economy.

## **5.2 RECOMMENDATIONS**

Based on the findings of the previous chapter, the following recommendations can be adopted to strengthen the existing SEZ model in Kenya and to further promote the implementation of a successful SEZ model in Kenya like China.

### **5.2.1 STRENGTHEN THE SEZ INSTITUTIONAL AND LEGAL FRAMEWORK THROUGH THE AMENDMENT OF THE EXISTING LEGAL FRAMEWORK**

The Chinese government support of the model has led to its success over time.<sup>267</sup> The decentralization of power by the central government helped prevent political interference of the zones by the main government.<sup>268</sup> At the same time, the municipal governments administering the SEZs within the zones brought about efficiency as the local governments are able formulate laws that are specific to their economic needs.

Kenya needs to adopt this method where the government decentralizes its power and allows the SEZs to administer and control the enterprises located in the zones. This is important because the local governments are more informed of the economic policies that best suit their localities.

Kenya can also strengthen this model by ensuring that the existing legal framework is complied

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<sup>266</sup>Allan Odhiambo 'Kenya EPZs ranked low on wealth creation' *Business Daily* (Nairobi, 10<sup>th</sup> March, 2016) <https://www.businessdailyafrica.com/markets/Kenya-EPZs-ranked-low-on-wealth-creation-/539552-3111746-4eh6tt/index.html> accessed on 13th March 2019.

<sup>267</sup>FIAS. 2008. Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development. Washington, DC: World Bank.

<sup>268</sup>Zeng, Douglas Zhihua. Global Experiences with Special Economic Zones : With a Focus on China and Africa. World Bank(2015)Washington, DC. © World Bank.

with. One example of this is the criteria for setting up SEZs that should be strictly adhered to. Any arbitrariness in their setting up by politicians for political leverage purposes during electioneering periods should therefore be avoided. Only those SEZs that are formed in accordance with the legal procedure should be licensed and allowed to operate in the country.

Amendment of the existing legal framework should also be undertaken to include the labour rights of those employed to work in the SEZs. The Act should be such that the minimum wages payable to workers is provided. The Act should also protect the workers from exploitation and ensure that a conducive working environment is maintained in these zones for example through the provision of protective clothing. Provision of insurance is another area that the law should address so as to ensure that employers take out insurance for their employees in case of injuries sustained during work hours.

As earlier discussed in Chapter one of this paper, legal realism is an important jurisprudential theory to be considered by the drafters of law on this model. They should ensure that the legal framework is alive to the political, moral, social and economic needs of the country for it to actually make a difference in Kenya's economic liberalization ambitions by the year 2030.

### **5.2.2 INSTITUTIONAL AUTONOMY**

The Chinese SEZs have legislative authority to make their own laws. This autonomy enables them to formulate policies and other economic measures which are important in their operations.<sup>269</sup> The SEZs in Kenya would benefit if such an approach is taken as they would put in place laws that are specific to their conditions. For example an SEZ located in Mombasa has different laws and policies it should pursue compared to an SEZ located in Eldoret due to their economic, topographical, cultural, climatic and infrastructural differences.

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<sup>269</sup>Wang, Jin. 2013. "The economic impact of Special Economic Zones: Evidence from Chinese municipalities", *Journal of Development Economics*, Volume 101, 2013, pp133 – 147.

### **5.2.3 ADOPTION OF FAVOURABLE ECONOMIC POLICIES**

China has put in place the open door policy which allows foreign countries to trade with it in an equal platform.<sup>270</sup> Kenya needs to come up with economic policies that attract investors to the country so as to expose it as an investment hub to potential investors. One way this can be done is through the introduction of fiscal and non- fiscal benefits to the investors, rapid customs clearances as well as easily obtainable work permits for foreigners and introduction of research funding.

### **5.2.4 ELIMINATION OF CORRUPTION**

Corruption is one of the factors that leads to failure of SEZs in any economy. Where a firm has to pay bribes in order to acquire various permits to set up an SEZ, this in turn increases the chances that it must pay more in bribes than it makes in profits<sup>271</sup>. With such practices, SEZs can become a vehicle for corruption which makes the system unpredictable for investors. This can eventually kill economic growth in the country which has been the case with Tatu City.

China has embraced a strict policy towards corruption and introduced the death penalty as the ultimate deterrent for those found guilty of this offence. This law has seen various government officials prosecuted for the offence. Kenya needs to follow in the footsteps of China and embrace stricter laws for corruption and go further to prosecute the culprits regardless of their social or political status.

### **5.2.5 INVESTMENT INCENTIVES**

China has put in place various incentives as a way to attract investors to invest in the zones. Some of these incentives include transparent administrative processes, good infrastructure, rapid

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<sup>270</sup>Ge, Wei. 1999. "Special Economic Zones and the Opening of the Chinese Economy: Some Lessons for Economic Liberalization." *World Development* 27 (7): 1267–85.

<sup>271</sup>Moberg Lotta, "The Political Economy of Special Economic Zones" (2015) *Journal of Institutional Economics* 22.

customs clearance, simplified exit and entry procedures, reduced taxes and flexible labour laws among others.<sup>272</sup> Other policies are also in place to draw in labour into the firms, such as housing for the staff and provision of subsidies and grants for purposes of education. While the SEZ Act provides for some monetary benefits, there needs to be non-monetary incentives in place to attract investors in the zones like the case in China for example, provision housing and subsidies and grants for purposes of education.

### **5.2.6 GEOGRAPHICAL ADVANTAGES**

SEZs in China are strategically located in near major cities or along the coast line in order to open up the zones to international markets. Quality infrastructure is also a key consideration before setting up the zones.<sup>273</sup> While the Act does provide for the criteria for evaluation before designating an area as a SEZ with factors such as infrastructure, politicians have undermined the SEZA by promising the public the establishment of SEZs in their regions as tool to get votes during election periods<sup>274</sup>. Such declarations must be avoided as the function of determining the establishment of an SEZ belongs to the SEZ Authority. Where such zones are established without following the criteria, it can lead to numerous instances where companies evade paying taxes by creating subsidiaries in the SEZ's which can consequently lead to the loss of income for the country.<sup>275</sup>

### **5.2.7 COMPREHENSIBLE OBJECTIVES AND GOALS**

In China, the SEZs were initially four and subsequently increased in number with their success. These zones have clear goals and targets when it comes to the direct and indirect economic

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<sup>272</sup>FIAS. 2008. *Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development*. Washington, DC: World Bank.

<sup>273</sup>Wong, Kwanyiu. 1987. "China's Special Economic Zone Experiment: An Appraisal." *Geografiska Annaler Serices B, Human Geography* 69 (1): 27–40.

<sup>274</sup>Section 13 of the Special Economic Zones Act, No. 16 of 2015.

<sup>275</sup>Otiato Guguyu and Macharia Kamau, 'Is Kenya overbanking on new Special Economic Zones to drive growth?' (Nairobi, July 25<sup>th</sup> 2017)2

benefits to be achieved.<sup>276</sup> These targets provide a template in which the leaders of these zones are expected to achieve. The SEZs in China are also highly competitive among themselves which makes them successful.

When this model was introduced in Kenya, real estate speculation was one of the areas that was heavily invested in. This was a mistake that China also made but went ahead to redeem itself eventually<sup>277</sup>. Kenya should therefore have clear objectives before embarking to establishment of these zones and allow for competition between the zones to allow for transparency in their management and performance.

### **5.2.8 SKILLS TRAINING**

Sufficient manpower is a necessary ingredient during the operations of SEZs. The SEZs in China have well-equipped training centers which provide potential employees with relevant training and skills. The firms in the zones partner with the education institutions in the country to provide them with necessary workforce.<sup>278</sup> Kenya can adopt such steps so as to attract highly qualified people to provide labour in the zones.

### **5.3 CONCLUDING STATEMENT**

The impact of the SEZ model on economic growth continues to be accepted globally and has been implemented in many countries due to its success in China.<sup>279</sup> This paper has examined China's legislative and institutional framework on the SEZ model and compared it to the Kenyan Model. It has gone further to identify the weaknesses that exist in the Kenyan model and given

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<sup>276</sup>Sung Y. *The China-Hong Kong Connection: the key to China's open-door policy*. Cambridge: Cambridge University Press, 1981.

<sup>277</sup> Wang, Jin. 2013. "The economic impact of Special Economic Zones: Evidence from Chinese municipalities", *Journal of Development Economics*, Volume 101, 2013, pp133 – 147.

<sup>278</sup>Ibid 146.

<sup>279</sup>Zeng, Douglas Zhihua. *Global Experiences with Special Economic Zones: With a Focus on China and Africa*. World Bank(2015) Washington, DC. © World Bank.

recommendations on how to alleviate them. Kenya and China have over the years developed strong bilateral relations which continue to yield benefits for both parties economically. The Africa Economic Zone SEZ in Uasin Gishu County and the Friendship City SEZ in Nairobi's Athi River which was launched in March 2019 are good examples of the product of cooperation between Kenya and China.

The enactment of the SEZ Act of 2015 and the SEZ regulations of 2016 by Kenya is a positive stride in the implementation of this model. However, there remains to be several legislative weaknesses that need to be addressed in order for the country to achieve economic liberalization in accordance to its economic pillar in Vision 2030. However, it is important to note that despite this success by China, this model has to be carefully implemented in accordance to Kenya's specific conditions for it to achieve the desired results.

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