Exporting Firms in Disguise: The Case of the Chinese Special Economic Zone in Mauritius

Working Paper

Chinese Special Economic Zones in Africa (CSEZAs) is the technical term which refers to the trade and economic cooperation zones that China builds in Africa, to the image of its own domestic Special Economic Zones (SEZs) introduced by Deng Xiaoping in the 1970s. In November 2006, at the third Forum on China - Africa Cooperation (FOCAC) ministerial, the then-President Hu Jintao committed to the realisation of eight projects in order to 'forge a new type of China-Africa strategic partnership and strengthen…cooperation'. Seventh on the list of cooperation projects was to '[e]stablish three to five trade and economic cooperation zones in Africa in the next three years' (Jintao 2006).[1] A survey of the remaining items on the list reveals that China had given a thorough thought and planning to the entire mechanism, which was to support the exportation of these zones. Evidence of this postulation is the presence of item number three on the list, which alluded to the establishment of 'a China - Africa development fund which will reach US$5 billion to encourage Chinese companies to invest in Africa and provide support to them' (ibid.). The latter endeavour was clearly in tandem with the CSEZA projects, as both the CSEZAs and the China - Africa Development Fund (CADFund) complement each other's needs and objectives. As the Chinese SEZs unfold in Africa, other instances reflective of China's well-organized foray into Africa through an instrumentalisation of the CSEZAs comes forth. Consequently, as China secures its share of 'wins' from this 'win-win' cooperation venture, the other half of the benefits which were to go to the host African countries, remains evasive. This paper highlights the mechanisms through which China is able to extract independent benefits out of this cooperative venture, at the expense of and to the disconcertion of its African partner.

The partnership equation implied by the CSEZA model establishes the tacit consent that while China will bring in capital, expertise, investors and technology to the project, the African host should make provision of the land, off-site infrastructure and a preferential fiscal package. It is a combination of both inputs which will generate profits and developmental goods (such as job opportunities, foreign exchange income, backward linkages, transfer of technology and know-how). These benefits will be shared between the Chinese and the African countries. Given that the geographical jurisdiction within which this developmental venture is taking place is African, the host country will be able to make the most of the benefits of social, educational as well as financial nature. In contrast, the benefits that the Chinese partner will acquire will mostly be of fiscal nature. However, a study of the contemporary experience of the CSEZAs reveals that in most cases, where Africa has its investment inputs to the zones ready, China still lingers in applying these African assets into a process of value-creation which will generate the developmental outcomes Africa needs.

Section 1: Africa's Inputs

Authors such as Auty (2011, p. 222), Brautigam, Farole and Xiaoyang (2010, p. 5; Brautigam, 2011, p.47) document the preferential inputs that the host African countries have extended to China in regard to the CSEZAs—in addition to land. Below is a list of the provisions that the host African countries especially designed for the CSEZAs.

(i) *Nigeria*: General Nigerian Free Trade Zone regulations allot 25 per cent sales to domestic market while the Lekki Free Trade Zone (LFTZ) is allowed 100 per cent domestic sales, if the product is made from 100 per cent local materials. While this encourages the CSEZ investors to source raw materials locally, it also creates market competition for the local Nigerian manufacturers.

Ogun - Guangdong Free Trade Zone (OGFTZ) allows withdrawal of investment and capital at any time. This clause enables investors to fully exploit the preferences granted by Nigeria—even using its export quota to the United States of America (USA) and the European Union (EU), thereby penalising local exporters—and then, leave whenever suitable. This jeopardises possibilities of technology transfer. The fact that no residence permits are required for foreign employees not only contradict the general requirements, but is also in paradox with the Expatriate Quota measure of Nigeria as it encourages an inflow of long-term foreign workers.[2]

(ii) *Ethiopia*: Except for bearing 30 per cent of the on-site infrastructure cost, Ethiopia does not give the zone any special treatment.

(iii) *Egypt*: As at date, Egypt TEDA has not been granted any preferential incentive and gets a treatment uniform to that received by other zones falling under the Special Economic Zone Law of 2002. However, Egypt TEDA has recently expressed interest in expanding its zone and seeks to own the land instead of having to rent it.

(iv) *Zambia*: Although Zambia does not provide any active concession to both Chinese zones, the fact that Zambia-China Economic and Trade Cooperation Zone (ZCCZ) is passed off as a Multi-Facility Economic Zone (MFEZ) despite the fact that its activities concentrate on mining only, makes Zambia miss out on profits and royalties that it could have gained through treating ZCCZ as an integrated mining industry.

(v) *Mauritius*: Technically, Mauritius made only three concessions; firstly, over provision of off-site infrastructure; secondly, the provision of a passport to financially eligible investors; and thirdly, by extending the lease period of state land from 60 to 99 years. But, while these are the only direct policy preferences that Mauritius entertains in regard to the CSEZ, the island also indulges in indirect preferential treatments which are not detectable at a first look. Allusion is here made to timely modifications in existing legal provisions in order to make way for the CSEZ project.

Some examples are:

- Changes were made to the State Lands Act 1945 in order to give better rental terms to the Chinese developers. The relevant section now reads 'where a large investment project is deemed by the Minister, subject to approval by the Cabinet, to be in the economic interest of Mauritius, the annual rent determined in accordance with that subsection shall be reduced by such amount as may be determined by the Minister and *any lease may be granted for a period not exceeding 99 years, with the approval of the Minister*, subject to approval of Cabinet' [emphasis mine].

- The Professional Architects' Council Act 2011 which allowed foreign architects to partake in the designing of construction of infrastructural projects in Mauritius, only if (i) the project is the construction of a Government building, (ii) the foreign architect is under a joint venture agreement with a professional architect or firm, (iii) the project is of the construction of a statutory corporation or Government company, (iv) the foreign architect is appointed by the Public Service Commission (PSC), was changed. The architectural contract for the Jin Fei zone has been granted to the Chinese company, Artech.
- Similarly, Mauritius has disregarded all the legal stipulations agreed to in the lease contract with the Chinese developers which provides it ground to notify, pressurise or cancel the land lease if the construction schedule is not met. The construction schedule committed to the development of the CSEZ to be completed in two phases: Phase one starts in September 2009 and ends in September 2012, and phase two starts in September 2010 and ends in September 2016.

The above incentives given to the CSEZAs by the African governments only put the lack of developmental outcomes produced by the Chinese developers into perspective. Using the example of the Mauritian CSEZ project called the Mauritius Jin Fei Trade and Cooperation Zone Co. Ltd (JFET), we shall present samples reflecting the unmatched commitment of the Chinese party.

Section 2: CSEZA's Mismatched Deliverables

As a Sub-Saharan African island with no natural resources and a skewed reliance on its human capital and geographic position, the Mauritian CSEZ experience pose as the worse-case scenario of the remaining four African host countries. Therefore, the impact the CSEZ has on Mauritian developmental aspects is, to a great extent, prototypical of what Egypt, Ethiopia, Nigeria and Zambia are likely to undergo—if not worse. The three areas upon which the CSEZ has the most immediate impingement are: backward linkages, employment and foreign trade.

(i) *Backward Linkages:* It is noted that the areas of investment of JFET will overlap with the high income generating industries of the Mauritian domestic trade area of Mauritius.

Main Industries contributing to GDP growth in Mauritius 2010	Areas of Investment in Jin Fei
Manufacturing (Garment, Processed Fish, Beverages, watches, clocks, toys, optical goods, jewelry, travel goods, handbags, textile yarns, fabrics and made up articles, pearls, semi/precious stones, wood manufactures)	Garment Manufacture Tourism Souvenir Manufacturing[3] Food Processing

Real Estate and Business	International Conference Center Staff dormitories
Hotels and Restaurants	Hotels
Wholesale and Retail Trade: Repair of Motor Vehicles, motorcycles and personal and household goods	Electric House Appliances Light Engineering Wholesale and Retail Shopping Centers
Financial Intermediation	Financial Services
Other Services	
Transport and Communications	ICT
Construction	
Health and Social Work	State-of-art medical Centre Pharmaceuticals
Education	Boarding School
Public Administration	
Electricity, Gas and Water Supply	

Figure 1.1: Domestic Areas generating high GDP and overlapping Jin Fei Investment Areas
Source: Compiled from CSO Quarterly National Accounts 4th Quarter 2010 and Parliamentary Questions Sessions

As the products and services of the zone overlap with the lucrative industries of the domestic trade area, there will be strenuous competition over markets. Moreover, with similar activities taking place in both, there will be no exchanges of know-how, skills and technology. The Chinese will be unwilling to part of their trade and technology secrets to their Mauritian competitors.

(ii) *Employment Creation:* Since the inception of JFET, figures of prospective employment creation announced by involved parties have been incongruent. In 2008, Mauritian authorities estimated the creation of 7500 jobs, and in 2010, the number rose to 35000—only to be countered by a figure of 5000 jobs targeted by the CEO of the project (Mauritius. Parliament, 2010, 20 June; Li, 2010). While at various times, Chinese government and the zone promoters have denied their intention to bring Chinese labour to Mauritius, the inclusion of a staff dormitory in the plan of the CSEZ indicates that the zone will, in fact, be welcoming foreign labour.[4] We already have a preview of this trend, as the employees working at the only factory presently on the site are Chinese and Bangladeshis.

Given that Chinese unregulated work culture does not match the stringent labour ethics of Mauritius, there are possibilities of conflict. A paper by the International Confederation of Free Trade Unions on export-processing zones describes an event of such a clash. It reports about how Mauritian authorities had to intervene to restore the rights of Chinese immigrant workers in Mauritius (Perman et al, 2004, p.43): 'Chinese women workers recently went on strike to protest that, having paid a 1,000 dollar recruitment fee, their wages were then paid in dollars directly to the recruitment agency, leaving them barely 200 to 300 rupees. The Mauritian authorities are now insisting that the Chinese workers receive their full wages and that the recruitment agencies are officially registered by the Chinese authorities.'

(iii) *Foreign exchange income:* The current commercial relationship shared by Mauritius and China is highly imbalanced. In 2009, Mauritian imports from China amounted to USD$539.9M. The products were mainly manufacturing, machinery, food and animal products, chemicals, crude materials, beverages and vegetable and animal fats. On the other hand, Mauritian exports to China for the same period were only USD$ 181,159.42. In 2008, Mauritian exports to China had been USD$579,710.14. Therefore, over one year, there had been a reduction of 52% Mauritian exports to China. The figures below show that this trend will persist.

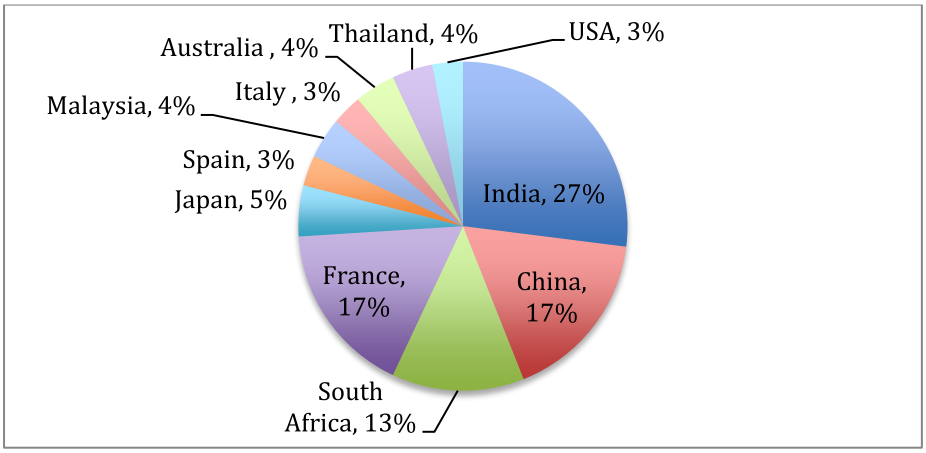


Figure 1.2: Mauritian Imports 2009
Source: Ministry of Finance and Economic Development, Mauritius Central Statistics Office, Digest of External Trade Statistics, 2009

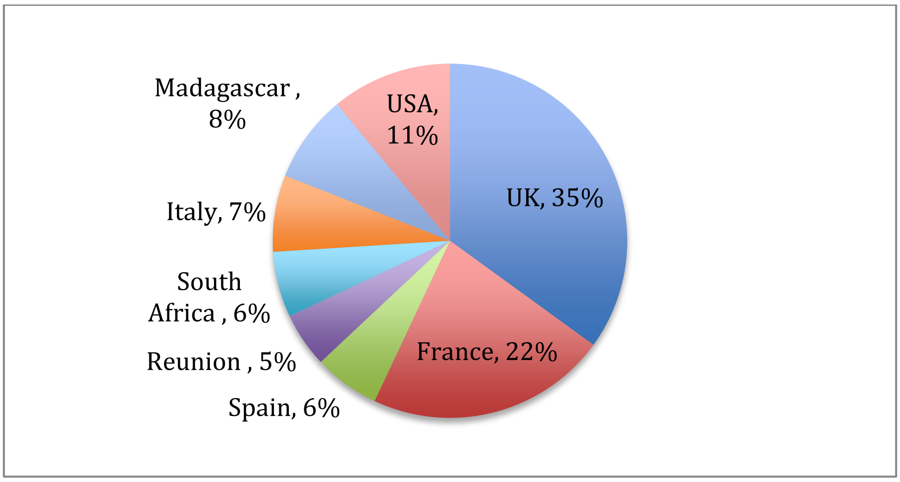


Figure 1.3: Mauritian Exports 2009 Source: Ibid

In light of the current trade imbalance that marks the relationship between Mauritius and China, the JFET project will further negatively impact domestic accumulation of trade income of the island. This is because the companies operating from within the zone will compete for the same markets targeted by the local entrepreneurs. Already, local Mauritian companies are struggling against cheaper Chinese products that have flooded the market. They will now face added pressure to match up with the predictably lower production costs and selling price of Chinese enterprises.

Meanwhile, JFET investors will secure a larger share of profits and repatriate their profits to their headquarters in China at no cost, as according to the provisions of Board of Investment (BOI). They are unlikely to reinvest their earnings in development or value-added projects in Mauritius.

As we can observe, while the African governments have done their share of investments and concessions for the CSEZAs, the Chinese developers have failed to deliver the 'cooperation and mutual development' they promised. But while Africa has not been able to benefit much from its inputs within these zones, China has nonetheless been able to assure a considerable number of gains for itself from the non-performing CSEZAs, thereby securing their subjective share of benefits from this cooperative venture. Hence, the question that stands is how did the Chinese developers and investors manage to extract advantages from the CSEZAs when the zones are still undeveloped or stagnant and are yet to generate profitable outcomes for the host African country?

Section 3: Extracting Profitability from Failed Cooperation

This independent and subjective profitability that China extracts from African assets, at the expense of the host itself while altogether being located within the host's territory, is enabled through distinct strategies employed by China. Therefore, not only do the Chinese developers fail to create employment opportunities, backward linkages, technology-transfer, but through these strategies, they actively contribute to an underdevelopment of the African host country and fuel they own profitability.

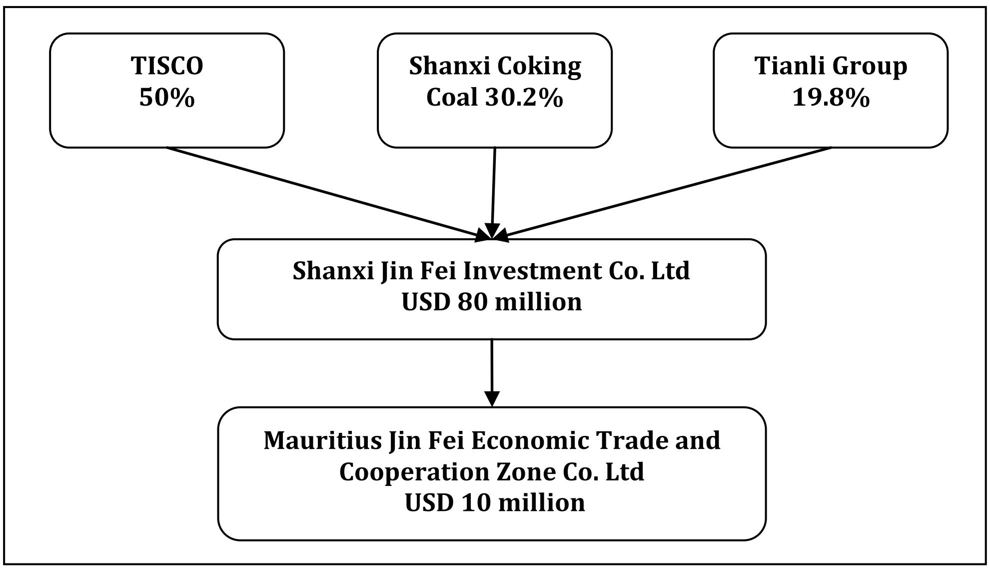
(i) *Setting up of companies whose nature do not fulfill the mutual cooperation purpose of the CSEZA:* One way through which African development can be met is by engaging with the local businesses through backward linkages. This involves activities such as buying raw and intermediate materials from the local producers, sub-contracting parts of the manufacture of the products or provision of the services to local parties or by transferring new technology or skills to the local businesses. Technically, the first step towards fulfilling this commitment of cooperation with Africa would be to avoid developing industries in which the local African businesses have already established themselves--especially, if it is a sector in which small and medium enterprises thrive. By violating this simple ethic, the CSEZ developers position the zone in antagonism to the host African community. Not only does this create competition and cuts down the share of national income but it also diminishes chances of passing on new knowledge and skills to the host country.[5] As seen in the case of Mauritius, the Chinese developers established their own subsidiary travel company called JFET Travel and Tours Ltd. Travel agency is a service that is largely available in Mauritius and is dominated by small entrepreneurs. The setting up of Oriental Group (Mauritius) Industry Co. Ltd within the zone also trampled similar sensitive lines. The project was contested by the local cement producer, United Basalt Products Ltd (UBP). UBP has had an existence on the island since 1953 and currently shares the Mauritian market only with Lafarge. The arrival of Oriental Group (Mauritius) Industry Co. Ltd, who will also be allowed to sell its products to the local market, threatens to take away a share of national wealth to China (Yajing, 2011).[6]

(ii) *Involvement of shareholders in projects outside the CSEZA:* Chinese stakeholders have also gotten get active in projects situated outside the zone. For instance, the involvement of Shanxi Coking Coal Group Co. Ltd (one of the three shareholders of JFET) in the coal-powered power plant called The (Mauritius) CT. Power Ltd. It is highly possible that Shanxi Coking Coal may shift its focus onto the power plant plan since its specialisation and experience is in coal. Moreover, compared to direct engagement it is bound to in the CSEZ, Shanxi Coking Coal Group Co. Ltd will be less pressured to cooperate in the power plant project given its status as a subordinate associate. Therefore, it will have to risk lesser inputs, but at the same time, the profits it will earn through direct sales of its services and products will be greater.

(iii) *The use of Special Purpose Vehicles (SPVs):* The use of this particular strategy serves more to prevent any loss then for active extraction of profits. SPVs is key to China's way of conducting business in foreign locations. A definition of An SPV is:

> a legal entity created by a firm (known as the sponsor or originator) by transferring assets to the SPV, to carry out some specific purpose or circumscribed activity, or a series of such transactions. SPVs have no purpose other than the transaction(s) for which they were created, and they can make no substantive decisions; the rules governing them are set down in advance and carefully circumscribe their activities. Indeed, no one works at an SPV and it has no physical location (Gorton and Souleles, 2007)

In the Mauritian CSEZ, the developers make use of double SPVs. Shanxi Jin Fei Investment Co. Ltd is the first SPV. It is set up in China and is composed of Shanxi Coking Coal Group Co. Ltd, TISCO, and Shanxi Tianli Enterprise Group. It has a fund of USD80 million which will go towards investment in the CSEZ project in Mauritius. Mauritius Jin Fei Economic and Trade Cooperation Zone Co. Ltd (JFET) is the second SPV, set under Mauritian jurisdiction. Its shareholding company is the Shanxi Jin Fei Investment Co. Ltd and it has a total fund of USD10million. Thus, instead of a direct investment, the three ultimate shareholders, i.e. Shanxi Coking Coal Co. Ltd, TISCO, and Shanxi Tianli Enterprise Group, built two protective layers of financial instruments in between themselves and the zone.



The use of SPVs in the case of JFET serves three selfish objectives of the Chinese developers:

1. It permits a slow phasing-in of capital (here, from the USD 80million fund of the non-orphan SPV to an immediate investment of only USD10million in the orphan SPV). Thus, the developers are able to remove their money from the CSEZA project if and when they wish to.

2. In view of the Double Tax Avoidance treaty (DTA) that Mauritius has with China, the Mauritius-based SPV, Mauritius Jin Fei Economic Trade and Cooperation Zone Co. Ltd is exempted from the payment of any withholding tax on capital gains gained by the disposition of Chinese equity.[7] Moreover, withholding tax on dividends paid by a company based in Mauritius is held at 5% instead of the 20% applicable to companies functioning from a non-DTA jurisdiction.[8] Nevertheless, currently, the Jin Fei developers are not being able to make the most of this arrangement because outbound investment or repatriation of money from Mauritius Jin Fei Economic Trade and Cooperation Zone Co. Ltd and its subsidiary, JFET Travel and Tours, to China is negligible. However, the idea that the zone was set up in Mauritius under SPV format with the intention of benefiting from this profitable fiscal regime cannot be dismissed.

3. SPVs, by virtue of their structure and function, allow for the isolation of financial risks. Thus, Shanxi Coking Coal Group Co. Ltd, TISCO, and Shanxi Tianli Enterprise Group isolate their corporate activities from being affected by this single overseas SEZ investment.

Through an application of these strategies, these CSEZAs, which are non-performers to the African eye and expectations, have turned out to be profitable ventures for China. As we gauge this one-sidedness of the CSEZAs, the recurrent concern that emerges is to whom to attribute the responsibility for this unbalanced implementation of cooperation. Does the fault lie in the willingness of Africa to be accommodative of Chinese requirements or in the creativity of the Chinese developers, capable of extracting profits from even unworkable models of cooperative development?

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[1] The use of the term 'economic and trade cooperation zones' by the Chinese purely denotes the function that these zones in Africa are meant to carry out. The technical name by which these endeavours are otherwise referred to in academia and also by the policy-makers is Chinese Special Economic Zones in Africa.

[2] The Expatriate quota is the mechanism regulating the employment of foreigners in Nigerian companies. The aim behind it is to monitor the areas and terms of expatriate employment in a way that local Nigerians are prioritised if they have the required skill for the job.

[3] Souvenir Manufacturing in JinFei will create difficulties for local souvenir manufacturers who consist mostly of women and laid-off workers. Organisations like National Women Entrepreneur Council (NWEC) and Small and Medium Enterprises Development Authority (SMEDA) have specialised schemes encouraging unemployed and laid off workers to opt for such low cost businesses. NWEC currently registers 240 handicraft manufacturers.

[4] This is because given the size of Mauritius, all Mauritians commute daily to their work place and do not take up residence at the workplace.

[5] The share of national income is compromised here because while the local manufacturers keep the profits they garner in Mauritius itself and usually reinvest the money locally, the profits earned by the Chinese company will be remitted to China. It will not add to the national income. This is because as most of the host country governments, Mauritius too has agreed to a zero per cent charge on repatriation of profits.

[6] A similar occurrence was noted in relation to the Ethiopian SEZ shareholders, whereby the CSEZ developer--Jiangsu Qiyuan Group Co Ltd--with the support of CADFund, set up the Ethiopian East Cement Share company within the zone in 2006. This is despite the fact that Ethiopia already has enough cement plants to supply for the demands of the local market and that local producers have only recently started exporting cement. In fact, it is in order to regulate this market and give prominence to its local manufacturers that in 2012, the Ethiopian government banned the import of cement. Thus, the Chinese cement company impinges upon the income that could be generated and consumed by the Ethiopian local businesses.

[7] Not applicable to companies holding more than 25% of the concerned Chinese entities.

[8] It is to be noted that of the Chinese DTA-favourable jurisdictions, Mauritius is the only one that benefits from a 5% rate on all the dividends. Otherwise, 5% on all dividends is only received in those cases whereby the beneficiaries hold no less than 25% equity in the company paying the dividend.