Lesotho Special Economic Zones: feasibility study

Feasibility report prepared for Lesotho Ministry of Trade and Industry

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Acknowledgements

This report is part of a joint initiative of the Lesotho Ministry of Trade and Industry and the African Development Bank through the Economic Diversification Support Project to examine the feasibility of a Special Economic Zone regime in Lesotho.

The analysis was carried out by a team led by Vivid Economics including Dan Aylward-Mills, James Patterson-Waterston, Shahbano Soomro, Giulio Vannicelli and Jake Wellman (Vivid Economics); Jean-Paul Gauthier (Locus Economica); Yash Ramkolowan (DNA Economics), Lehlohonolo Chefa and Manon Jones.

The work has been conducted in partnership the Lesotho National Development Corporation, which has provided significant information, feedback and strategic direction. The team wishes to thank all stakeholders who provided feedback and suggestions throughout the course of the work, including representatives from the Government of Lesotho ministries and agencies, development partners and private sector investors who participated in interviews and provided input to the study.

Executive Summary

The Lesotho Ministry of Trade and Industry and the African Development Bank, through the Economic Diversification Support Project, has commissioned a consultant team led by Vivid Economics to examine the feasibility of a Special Economic Zone regime in Lesotho. This report includes recommendations for developing an SEZ regime in the country and specific considerations for the offer to investors and development strategy for zones going forward.

Following 30 years of industrial policies centred around the provision of LNDC Industrial Estates to attract high-volume manufacturing (largely in the textiles sector), Lesotho is now considering what role Special Economic Zones could have in supporting its economic development objectives. This policy ambition is set out in the Lesotho National Develop Corporation's 2018-2023 Strategic Plan, which recognises that Lesotho's regional competitors tend to offer attractive investment regimes through the development of Special Economic Zones (SEZs). The Strategic Plan goes on to include the development of an agro-industrial Special Economic Zone under the goal 'Diversify Lesotho's Industrial Output and Market'.

Lesotho's Second National Development Plan (NSDP II) includes a specific focus on diversifying the economy and promoting industrial clustering; objectives which SEZs have helped to deliver in other countries. The Second National Strategic Development Plan includes the following intermediate outcomes: 'diversified products and effective business linkages' and 'operational industrial clusters and integrated supply chain'. The NSDP II encompasses four main key priority areas: inclusive and sustainable growth, human capital, infrastructure and national governance. The plan aims to link Lesotho's economic activities to large scale production and exports by the year 2023.

Table 1 Targets for inclusive and sustainable growth are identified in Lesotho's National Development Plan

	• Sustainable commercial and food security
	• Operational industrial clusters and integrated supply chain
	• Diversified products and effective business linkages
	• Improved and diversified tourism products
	• Improved creative industry
	• Strengthened research for policy making and product development
	• Functioning incubation centres and industrial parks

	• Sustainable commercial and food security
	• Improved use of Information and Communication Technologies

Source: National Strategic Development Plan II, 2018

In addition, Lesotho has identified four key sectors in its NSDP II to target private sector investment for development: agriculture, manufacturing, information and communication technologies (ICT) and tourism. The industrial strategy for the manufacturing sector will target diversification of products and integration of the value chain; product differentiation will help Lesotho decrease the level of vulnerability that comes with exporting a limited subset of products; deepening the value chain will help Lesotho's manufacturing sector take advantage of the presence of foreign owned firms by enhancing related backward and forward linkages.

Special Economic Zones are becoming an increasingly popular policy lever to attract foreign investment around the world, with more than 5,000 SEZs operating globally in 2019. These zones consist of geographically demarcated areas that offer tenants special incentives not available in the broader economy, including fiscal and financial allowances as well as special regulatory privileges and in many cases access to infrastructure. In Africa, SEZs emerged as a policy tool in the 1970s and have now been adopted by 38 countries in the region. Since then, they have become common across the continent. In 2018, there were approximately 237 established SEZs spread across 38 countries in the region (some of these still under construction). An additional 200 single factory Export Processing Zones (EPZs) exist in countries such as Kenya.

International, and Africa-specific, experience highlights that the development of a successful SEZ regime requires a clear vision and a long-term government commitment. SEZs are not a quick route to development, often taking many years before they provide significant positive benefits for the host economy. To ensure that parks are able to deliver on their full economic potential requires a clear vision of the value-add SEZs provide to the economy and a commitment by high levels of government to the long-term path to developing successful SEZs. Experience shows that to be successful, SEZ regimes will require:

- a long-term vision aligned with the wider economic strategy,
- a clear institutional and regulatory framework, often with a dedicated SEZ regulator, developer, operator and set of SEZ laws; and,
- a competitive incentive offering, including a mixture of physical infrastructure, tax relief and business facilitation services.

A lack of clarity affects Lesotho's current SEZ regime today. According to international organisations, including the World Bank and UNCTAD, provision of subsidised rent and hard infrastructure in Lesotho's Industrial Parks implies that the country already offers a type of SEZ. There is, however, no SEZ policy governing these Industrial Parks. The objectives of zones, their alignment with national economic strategy and the role of government in their development and operation remains ambiguous.

Across Lesotho's existing Industrial Parks, LNDC takes the responsibilities as sole developer, operator and investment promotion officer, under the governance of MTI. LNDC is currently responsible for all stages of Industrial Park development. In existing Industrial Parks, they prepare site feasibility studies, finance infrastructure and superstructure development, see to the management of facilities and provide investment facilitation and aftercare to occupants. Their efforts as operator and investment facilitator are supported through the departments of Property Development and Management and Investment and Trade Promotion department, respectively. Under the LNDC Law, the development of Industrial Parks is subject to oversight by MTI and MoF, which approve LNDC's development plans. This model leaves LNDC with little independent regulatory authority or financial autonomy. The core incentive offering of Lesotho's Industrial Parks is the provision of land and subsidised rental rates. A review of Lesotho's investment incentives highlights the majority of these are not 'special' to geographic areas and lack the spatial focus common for SEZ regimes.

Lesotho will need set out a clear vision for the proposed Special Economic Zones through a comprehensive SEZ policy. Learning from global best practice, the Government of Lesotho will also need to write a national SEZ policy that helps to guide the development of future SEZs. In the short-term, Lesotho's SEZ strategy can be to help improve the country's trade balance. By lowering the cost of doing business, SEZs can help to boost the competitiveness and attract additional FDI. Their investment focus and impact on competitiveness implies zones can help to increase Lesotho's exports. Where zones allow for the sale of goods into local markets, they can also enable import substitution, further supporting an improved trade balance.

In the medium to long term, Lesotho's SEZs can help to facilitate increased levels of industrial activity within and around the zone. Over time SEZs in Lesotho can develop an incentive offering targeted towards higher value-add industries. Zones can be used to attract FDI in new, increasingly complex types of economic activity, which help to diversify the country's export base. Well-structured spatial incentives can facilitate these spill overs through development of industrial clusters around Lesotho's SEZs. Zones can also support the development of Lesotho's priority sectors. Lesotho's National Development Strategy highlights several priority sectors, including agriculture and manufacturing, which can benefit from the host of incentives offered by zones.

Given the existence of Industrial Parks in Lesotho, the SEZ policy will need to highlight how new zones will differ from incumbents in their objectives and incentives. The development of a refreshed SEZ programme in Lesotho cannot ignore the type of SEZ which already exists in Lesotho, the country's eight Industrial Parks. These Parks benefit from below market rental rates, which could act as a source of competition to any incentives provided by a new SEZ regime. To address potential confusion between these types of SEZ, an SEZ policy will need to highlight the unique value add of the new set of SEZs will be their dedicated regulatory structure and their eligibility for financial and soft infrastructure incentives. Differing incentives are targeted towards the differing types of investment and objectives that Lesotho's existing and future zones will have. To further minimise the distortions resulting from existing Industrial Park incentives, it is also recommended that Lesotho removes any subsidy to rent on Industrial Parks to be developed in the future.

With these considerations in mind, and in light of the deliberative process that will likely accompany any SEZ development, there are a select number of characteristics of any SEZ regime that should be prioritised. These characteristics include:

1. first, a long-term policy commitment to attracting high quality foreign investment set out in an SEZ Act and supported through consistent and current government policies;
2. second, an internationally competitive incentive offering that reduces the cost of capital investment in an SEZ and facilitates expedient and effective regulatory support for foreign investors operating in an SEZ; and,
3. finally, a specified SEZ regulator for that is housed outside of ministry silos and empowered with the ability to expedite necessary regulatory processes to meet investor requirements, preferably through direct agreements with relevant ministries.

If these three conditions are supported by Government and communicated to investors, international experience suggested that the SEZs regime will be competitive to attract high quality capital investment to Lesotho. Without all three of these conditions being met, an SEZ regime is unlikely to succeed in Lesotho, and alternate policies should be prioritised, such as developing cost-effective industrial estates and improving the economywide ease of doing business. Based on the global practice and specific gaps identified for Lesotho the report provides a set of recommendations for an SEZ regime in Lesotho. Specific recommendations are provided for:

- SEZ strategy: including specific objectives and vision for the SEZ regime in Lesotho, geographical and sector focus, phasing and alignment with existing policies;
- investment incentive offering: including fiscal, financial, soft infrastructure and hard infrastructure incentives required to attract global investment in selected sectors; and,
- regulatory, legal and institutional structure: including governance and decision-making structures for SEZs and the regulatory framework to allow for their effective operation.

These recommendations are listed below:

Table 2 Summary of recommendations for an SEZ regime in Lesotho

Number	Recommendation
1	Lesotho should develop an SEZ policy which sets out a clear vision for Lesotho’s future SEZ regime and the need for an SEZ Law, prior to the development of any new zones.
2	Lesotho should, as a matter of urgency, finalise its national Industrial Policy, with the SEZ policy explicitly contributing to its objectives.
3	The objective of Lesotho’s SEZs should be to maximise investment in high value production.
4	The objective of Lesotho’s Industrial Estates should be explicitly stated as maximising employment.
5	The SEZ Policy should indicate priority sectors in manufacturing, but implementation should remain flexible and responsive to demand, including in the service sector.
6	Risk assessments should be undertaken to understand the impact of permitting investments in different sectors from locating within the SEZs.
7	SEZs should not be used as the primary tool for regional economic rebalancing.
8	Lesotho’s SEZ strategy should be structured around the development of hybrid zones that are flexible to align with investor demand within the context of relevant policies.
9	Eligible investors should be free to locate within an SEZ or Industrial Estate.
10	SEZ development should be reflected in the National Spatial Strategy where there is investor demand for clustering and agglomeration.

Number	Recommendation
11	Zones should be developed through a phased approach to allow room for growth, aligned with National Spatial Strategy timelines, including a pilot where there are credible development models in place (e.g. Mafeteng).
12	Learning and evaluation activities should be purposefully designed for both 1) pilot phase and 2) in regular intervals, such as the conclusion of a five-year policy.
13	Formal relationships should be developed with South Africa's SEZ programme, allowing partnerships with key zones in South Africa and those in Lesotho, allowing for facilitated inter-zone trade flows.
14	Fiscal incentives should be introduced to lower the effective tax rate in SEZs and encourage investment that raises productivity.
15	VAT and customs duties should be suspended on goods sold into or within the zone.
16	Lesotho should engage with international finance institutions to create a concessional finance facility for SEZ investments.
17	Lesotho should create an SEZ facility which contributes towards the costs of capital expenditure on technology, machinery and equipment, training, and research and development.
18	Ensure internationally competitive levels of utility and infrastructure service to new industrial land sites (off-site and on-site).
19	Transition from the subsidised support of rents to funding enhanced shared infrastructure across LNDC portfolio.
20	Enhance border infrastructure enabling easier cross-border transit of goods and feedstock associated with the zones.
21	Consider land reforms enabling wholly private ownership of land (or long-term protected land leases) for SEZ investors and developers.
22	A one-stop-shop (extension of OBFC) should be established in each zone to provide a range of business support and regulatory services which are core to the SEZ value proposition.
23	Ensure the provision of business support services, preferably through engaging the private sector in a PPP.
24	An SEZ Authority should be established through an SEZ Act.
25	The creation of a favourable business environment in SEZs should be achieved principally through service level agreements with relevant ministries, authorities and parastatals.
26	Prioritise the development of a robust PPP law and policy framework in Lesotho.

Number	Recommendation
27	An interim solution may be to establish an SEZ Unit in the Prime Minister's Office, with service level agreements between responsible Ministries and the LNDC (as a development partner).
28	The SEZ Authority Board should consist of key Ministers, with representation from the private sector, and chaired by either the Prime Minister of Deputy Prime Minister.
29	LNDC's role should focus on the promotion and development of SEZs
30	The full spectrum of public, private and PPP SEZs should be permissible
31	Private sector involvement in the development and operation of zones should be encouraged through a) legal eligibility of private developers in tenders for zone licenses, and b) government incentives to attract private developers through financing of feasibility studies and best practice PPP arrangements.

Source: Vivid Economics

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Acronyms and Abbreviations

ADR	Alternative Dispute Resolution	MFA	Multi-Fiber Arrangement
AfCFTA	African Continental Free Trade Agreement	MoF	Ministry of Finance
AfDB	African Development Bank	MFEZ	Multi-Facility Economic Zone
AGOA	African Growth and Opportunity Act	MoU	Memorandum of Understanding
BEPS	Base Erosion and Profit Sharing	MTI	Ministry of Trade and Industry
CIT	Corporate Income Tax	NSDP II	Second National Strategic Development Plan
DfID	UK Department for International Development	OBFC	One-stop-shop Business Facilitation Centre
EBA	Everything But Arms	PAYE	Pay-As-You-Earn
EPZ	Export Processing Zone	PCGS	Partial Credit Guarantee Scheme
EU	European Union	PMO	Prime Minister's Office
EZ	Enterprise Zone	PPFN	Project Preparation Facility Network
FAO	Food and Agriculture Organization	PPP	Public-Private Partnership
FDI	Foreign Direct Investment	R	South African Rand
FZ	Free Zone	R&D	Research and Development
GAP	Good Agriculture Practices	SACU	Southern African Customs Union
GDP	Gross Domestic Product	SADC	Southern African Development Community
GHP	Good Hygenic Practices	SCMA	Subsidies and Countervailing Measures Agreement
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit	SEZ	Special Economic Zone
GNI	Gross National Income	SEZA	Special Economic Zone Authority
GMP	Good Manufacturing Practices	SLA	Service Level Agreement
GVC	Global Value Chain	SME	Small to Medium-sized Enterprise

HACCP	Hazard Analysis and Critical Control Points	SPS	Sanitary and Phytosanitary Standards
HAI	Human Assets Index	SPV	Special Purpose Vehicle
HIV/AIDS	Human Immunodeficiency Viruses	SWOT	Strengths, Weaknesses, opportunities and Threats
HS	Harmonized Commodity Description and Coding System (Harmonized System)	TFTA	Tripartite Free Trade Area
ICSID	International Centre for Settlement of Investment Disputes	UAE	United Arab Emirates
ICT	Information and Communication Technologies	UK	United Kingdom (of Great Britain and Northern Ireland)
JICA	Japan International Cooperation Agency	UN	United Nations
LAA	Land Administration Authority	UNCITRAL	United Nations Commission on International Trade Law
LDC	Least Developed Country	UNCTAD	United Nations Conference on Trade and Development
LHWP II	Second Lesotho Highlands Water Project	US	United States (of America)
LNDC	Lesotho National Development Corporation	USD	United States Dollar
LRA	Lesotho Revenue Authority	VAT	Value Added Tax
LTCD	Lesotho Tourism Development Corporation	WASCO	Water and Sewerage Company
LEC	Lesotho Electricity Company	WBG	World Bank Group
LEWA	Lesotho Electricity and Water Authority	WTO	World Tourism Organization
M	Lesotho Loti	WTO	World Trade Organization

1 Introduction

1.1 Context of this study

Following 30 years of industrial policies centred around the provision of industrial estates to attract high-volume manufacturing (largely in the textiles sector), Lesotho is now considering what role Special Economic Zones could have in supporting its economic development objectives. This policy ambition is set out in the Lesotho National Develop Corporation's 2018-2023 Strategic Plan, which recognises that Lesotho's regional competitors tend to offer attractive investment regimes through the development of special economic zones. The Strategic Plan goes on to include the development of an agro-industrial Special Economic Zone under the goal 'Diversify Lesotho's Industrial Output and Market Destinations' (Lesotho National Development Corporation, 2018).

Special Economic Zones (SEZs) are becoming an increasingly popular policy lever to attract foreign investment around the world, with more than 5,000 SEZs operating globally in 2019 (United Nations Conference on Trade and Development, 2019b). These zones consist of geographically demarcated areas that offer tenants special incentives not available in the broader economy, including fiscal and financial allowances as well as special regulatory privileges and in many cases access to infrastructure.

Lesotho's Second National Development Plan includes a specific focus on diversifying the economy and promoting industrial clustering, objectives which SEZs have helped to deliver in other countries. The Second National Strategic Development Plan includes the following intermediate outcomes: 'diversified products and effective business linkages' and 'operational industrial clusters and integrated supply chain' (Government of Lesotho, 2018).

In support of these objectives, the Ministry of Trade and Industry and the Economic Development Support Project have commissioned this feasibility study of SEZs in Lesotho. This report includes recommendations for developing an SEZ regime in the country and specific considerations for the offer to investors and development strategy for zones going forward.

The findings of this report have been developed through both qualitative and quantitative analytical techniques including:

- a desk-based review of existing literature, including Lesotho country report, Government of Lesotho policies, strategies and legislation, and international reports on the success factors for SEZs;
- engagement with and input from international experts on SEZs;
- data analysis;
- high level financial modelling; and,
- stakeholder engagement in Lesotho.

1.2 Structure of this report

Figure 1 This report is structured around the themes of strategy, incentives and policies to facilitate the development of SEZs

Investment opportunities mapped (section 2)
- Current investment policies and industrial experience
- Priority sectors for industrial development in Lesotho
- SWOT analysis for priority sectors

SEZ experience and lessons (section 3)
- Global SEZ experience
- Experience of SEZs in Africa

SEZ strategy and vision (section 4)
- Best practice in SEZ strategy
- Key findings related to Lesotho's gaps

SEZ incentive offering (section 5)
- Best practice in SEZ incentives
- Key findings related to Lesotho's gaps

Regulatory and institutional framework (section 6)
- Best practice in SEZ policy
- Key findings related to Lesotho's gaps

Recommendations for SEZ development in Lesotho (section 7)
- Specific recommendations for Lesotho's SEZ regime

Action plan for developing SEZs in Lesotho (section 8)

Source: Vivid Economics

2 Overview of opportunities for investment and industrial development in Lesotho

Lesotho's economic activity is currently driven by government spending, with private sector activity concentrated in the export-oriented markets of diamonds and apparel. Government consumption accounted for about 26% of GDP in 2017,[1] maintaining a large presence in the local economy. The industrial sector is concentrated in a few export-oriented products, namely diamonds, apparel and electrical machinery. Agricultural production is limited to subsistence levels and food security remains a challenge, especially in rural areas.

2.1 Development objectives

Lesotho's Second National Strategic Development Plan (NSDP II) encompasses four main key priority areas: inclusive and sustainable growth, human capital, infrastructure and national governance. The plan aims to link Lesotho's economic activities to large scale production and exports by the year 2023 (Government of Lesotho, 2018).

Table 3 Targets for inclusive and sustainable growth are identified in Lesotho's national development plan

	• Sustainable commercial and food security
	• Operational industrial clusters and integrated supply chain
	• Diversified products and effective business linkages
	• Improved and diversified tourism products
	• Improved creative industry
	• Strengthened research for policy making

[1] https://www.cia.gov/library/publications/the-world-factbook/geos/lt.html

	• Sustainable commercial and food security
	and product development
	• Functioning incubation centres and industrial parks
	• Improved use of Information and Communication Technologies

Source: National Strategic Development Plan II, 2018

Lesotho has identified four key sectors in its NSDP II to target private sector investment for development: agriculture, manufacturing, information and communication technologies (ICT) and tourism. The industrial strategy for the manufacturing sector will target two main outcomes: diversification of products and integration of the value chain (Government of Lesotho, 2018); product differentiation will help Lesotho decrease the level of vulnerability that comes with exporting a limited subset of products; deepening the value chain will help Lesotho's manufacturing sector take advantage of the presence of foreign owned firms by enhancing related backward and forward linkages.

The NSDP II recognises that agricultural productivity will have to increase in order to guarantee food security and support export development. This will be achieved by improving the use of technologies and high-value crops in production, building sustainable infrastructure for agriculture and enhancing farmers' capacity (Government of Lesotho, 2018). Mining and construction also offer potential opportunities for economic growth and investment attraction in the future.

With a small domestic market (of less than USD 3 billion in 2018), expansion of trade is critical for Lesotho's future development. International trade to date has primarily been targeted towards the US, China and South African markets. Uncertainty around the African Growth and Opportunity Act (AGOA), which expires in 2025, brings further urgency to diversifying the Kingdom's trading partners.

2.1.1 Key objectives of Lesotho's industrial development strategies

Lesotho plans to promote inclusive growth and poverty reduction by attracting investment and fostering job creation. Among the country's macroeconomic objectives, reaching a stable 5% growth rate is identified as a minimum requirement to sustain poverty reduction and economic development (Government of Lesotho, 2018). This level of growth will create an additional 49,319 by 2023. Such growth and employment levels can only be supported by steady increases in investment, from the current level of investment of 27% of GDP (Central Bank of Lesotho, 2018) to 50% by the end of 2023 (Government of Lesotho, 2019a). Other policies aimed at promoting inclusive growth involve strengthening human capital formation, building enabling infrastructure and amplifying national governance and accountability.

The Kingdom aims to transition from a consumer-based to a producer and export-driven economy. Lesotho is currently a net importer of goods. The resulting current account deficit is financed through inflows into financial accounts, namely FDI and net transfers (Government of Lesotho, 2018). Lesotho plans to increase its share of exports by diversifying the range of manufactured products and its export markets (Lesotho National Development Corporation, 2018). Given Lesotho's small market size and geographical location, production and investment need to be export-oriented, with a greater focus on regional markets, in addition to the EU and the US (Ministry of Trade and Industry Cooperatives and Marketing, 2010). Such a shift in Lesotho's economic structure is seen as a route towards industrialisation and higher benefits for the local economy.

Box 1 Key industrial objectives for Lesotho

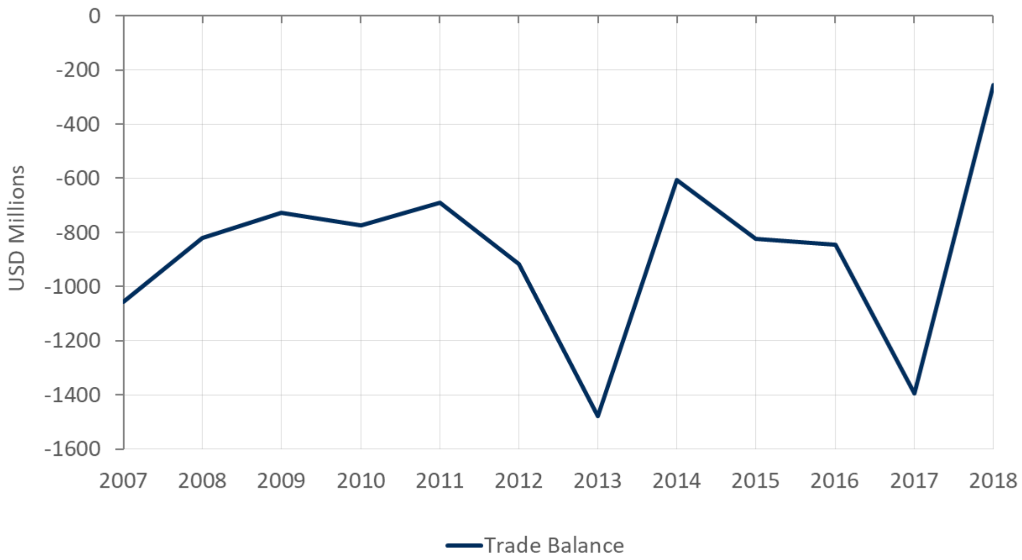
- Achieve 5% growth target to sustain inclusive growth and poverty reduction
- Attract further investment to meet target levels of employment and economic growth
- Diversify the range of products and the key export markets
- Promote and facilitate industrial restructuring with a thrust towards manufacturing and industry-related services

Source: (Lesotho National Development Corporation, 2018)

2.2 Trade and investment trends

Lesotho is a net importer of goods, with a current account deficit of USD 250 million which corresponds to 9% of GDP in 2018. Its trade is concentrated both in the products exported and in the main trading partners. In terms of exports, the country's top ten exported products mainly belong to the categories of precious metals, textiles and garments, electrical machinery and parts. The most relevant markets that these exports go to are South Africa for apparel and electrical machinery, the United States for apparel (which accounted for roughly 61% of all the clothing and apparel exports in 2016 (The World Bank, 2018)), the EU, and Belgium in particular, for precious metals and diamonds.

Figure 2 Lesotho imports USD 250 million more than it exports



Source: Vivid Economics, based on data from International Trade Centre

Top imports include mineral fuels, vehicles, electrical machinery and parts, mostly from South Africa (85% of total imports in 2017).[2] China and Taiwan are responsible for most of the remaining imports, especially in the area of textiles.

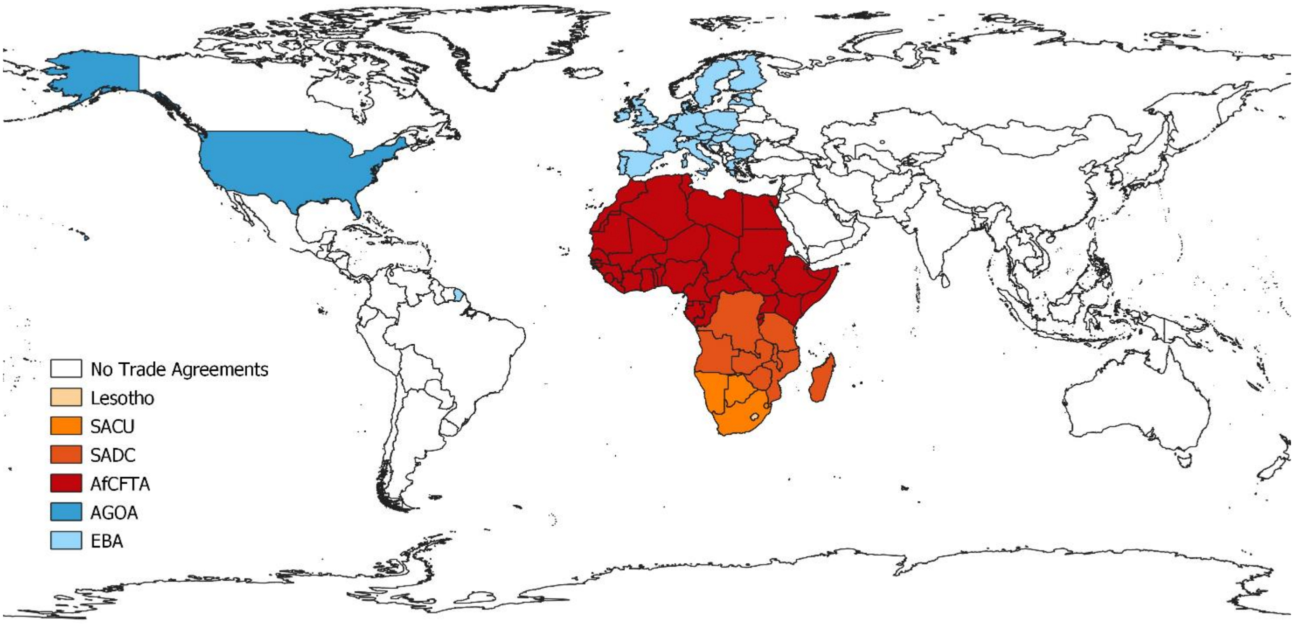
Lesotho is party to several regional trade agreements that connect the country with important economies at a local and global level. The key trade agreements that Lesotho is part of are the following:

- the Southern Africa Customs Union (SACU) allows Lesotho to enjoy duty-free access to the other markets included in the agreement (South Africa, Eswatini, Botswana, and Namibia);
- the Southern African Development Community (SADC) guarantees Lesotho similar benefits as SACU but at a much broader scale, since the agreement involves fourteen countries in Sub-Saharan Africa;
- the African Growth and Opportunity Act (AGOA) is a unilateral trade program that guarantees Sub-Saharan African countries duty and quota-free access to the US market. The agreement covers around 6,000 product lines, although most of trade currently happens within the textile sector. In order to qualify for AGOA treatment, each country must work towards improving its rule of law, human rights and core labour standards. AGOA has recently been renewed and will be in place at least until 2025. Expectations from the local US Embassy point towards a further renewal of AGOA after 2025. Studies suggest Lesotho should pursue niche markets in the future and explore other products besides textiles and clothing to maintain significant export shares to the US market (USAID Southern Africa Trade and Investment Hub, 2019);
- the Everything But Arms agreement (EBA) allows Lesotho to have quota and duty-free access to the EU market for all products except arms and armaments. In turn, the SACU area has removed duties on around 86% of imports from the EU. However, strict double-transformation requirements currently hamper Lesotho's textile exports towards the EU. This is one of the reasons why textile exports so far have been mainly directed towards the US, which has less stringent regulations; and,

[2] http://atlas.cid.harvard.edu/

- the African Continental Free Trade Agreement (AfCFTA) involves 54 signatory countries in the African continent. It provides a framework for trade liberalisation in goods and services and is set to be implemented in phases, for which the negotiations are ongoing. Among the 54 signatory countries, 27 of them still have to ratify the agreement, including Lesotho.

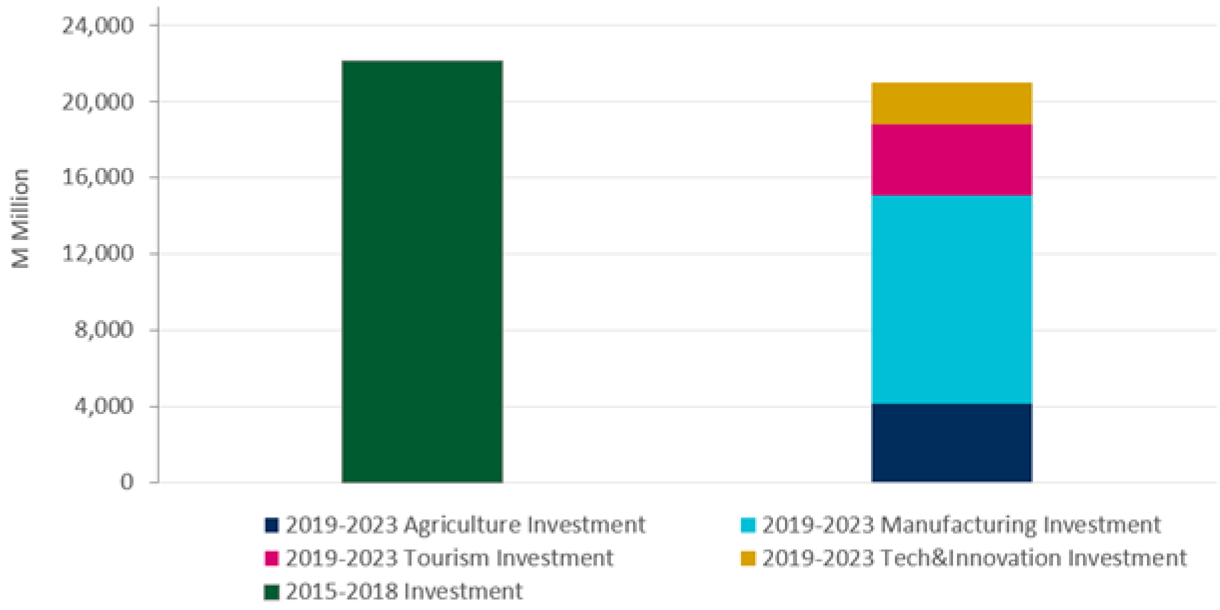
Figure 3 Lesotho benefits from preferential market access to many of the world's largest markets



Source: Vivid Economics

Expanding and diversifying the profile of foreign investors is a key aim of Lesotho's development plan. In 2018 total investment (foreign and domestic) in Lesotho stands at roughly 27% of national GDP, of which 8% comes from government sources and the remaining 19% from private sources (Central Bank of Lesotho, 2018). Government targets an increase in investment for the future, primarily from the private sector. By 2023, total investment is targeted to be close to 21,000 million Maloti and 95% of it will come from private agents (Government of Lesotho, 2019a). The manufacturing, agroprocessing and tourism sectors are seen as key opportunities to attract investment. FDI flows represent a much smaller share of total investment in the country, standing at 5% of Lesotho's total GDP in 2017 (United Nations Conference on Trade and Development, 2019a). However, this share has grown significantly in the last ten years and it more than tripled compared to twenty years ago.

Figure 4 Lesotho aims to attract more investment by 2023, especially in manufacturing



Source: Vivid Economics, based on data from Lesotho Economic Labs and the Central Bank of Lesotho

2.2.1 Barriers to trade and investment

Box 3 Many barriers limit trade and investment in Lesotho

- Limited resources from public revenue collection;
- Limited basic infrastructure coverage;
- Poor health conditions and services;
- Lack of technical and business skills;
- High costs of starting and operating a business;
- Limited access to local and international markets; and,
- Limited access to financial services for MSMEs.

Sources: Ministry of Trade and Industry Cooperatives and Marketing (2002) and Millennium Challenge Corporation (2018)

Improvements in the management of public revenues and services can enhance the government's positive impact towards growth and development. Refinements in the mechanisms of tax revenue collection can increase the amount of resources the government operates with. This is especially true for tax revenues from foreign owned textile manufacturers. Once tax revenues are collected, more structured public spending strategies can help find productive investment opportunities and increase the government's impact on the real economy. There is scope for improvement in the planning and coordination phases for other branches of public administration as well: policy drafting and implementation need to be responsive to national and transnational developments in order to deliver both timely national transversal plans and sector-specific strategies; engaging the right actors at the right level is a key step during this process. Improvements in governmental operations can positively impact a wide range of connected services which are currently underdeveloped, such as infrastructure: limited road connectivity inhibits access to market; poor water infrastructure prevents the agricultural sector from thriving and scaling up to commercial levels; insufficient access to electricity limits the spread of ICT services throughout the Kingdom. These barriers characterise Lesotho as a whole but are particularly marked in the Highlands.

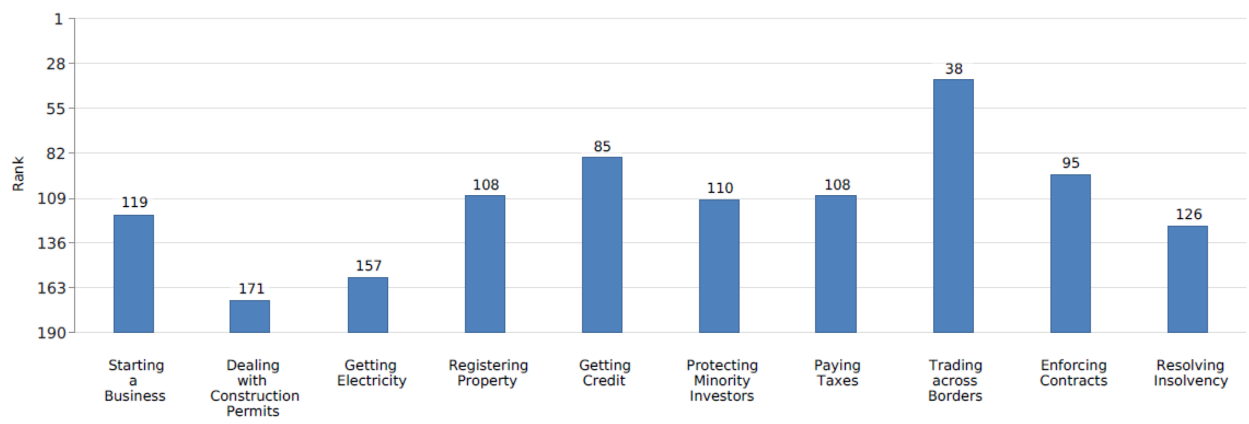
Poor health and lack of technical skills pose a barrier to human capital development and limit positive contributions to the labour market. Developing a workforce that is able to contribute to economic growth requires an effective and fully functional health system. Human capital development is also limited by the workforce's lack of adequate skills. Enhancing the skills base, particularly in the technical and business fields, provides a solid foundation for innovation and growth. There are gaps in primary and secondary education completion, and training provided rarely matches the technical and business skills that firms need. This in turn limits Lesotho's attempt to become a private sector driven economy.

Starting and conducting a business in Lesotho can be very costly and the related administrative procedures can bring significant delays to a firm's operations. The World Bank Ease of Doing Business indicator ranks economies based on whether their regulatory environment is conducive to the starting and operation of a local firm. In 2019 Lesotho ranked 106, climbing up eight positions compared to 2016[3] (The World Bank, 2019). However, the Kingdom's regulatory performance is still far from being attractive to international investors and represents a burden for local firms. Licensing in Lesotho is complex and subject to many delays. Given the large size of the informal sector, the extent of non-compliance to licensing regulations is probably significant. Regulation on licensing is not restricted to business registration, but also covers imports of goods and raw materials. Import licenses are only issued at one point in the country – Maseru – which contributes to slowing down the licensing process. Obtaining titles for land ownership also require costly and complex procedures, especially in the rural areas where property markets are highly illiquid and function poorly. During business operations, the lack of varied and abundant domestic sources of supply of materials in Lesotho force business owners to import them from South Africa. These supplies are often purchased in small quantities, as required by SMEs, thus increasing the cost per unit of material. Businesses have restricted access also to utilities; these include water, electricity and telephone, which are very costly and hard to obtain even in urban areas.

Local suppliers often fail to meet the sanitary and quality standards that advanced economies require. This in turn depresses export levels and worsens the Kingdom's trade balance (Millennium Challenge Corporation, 2018). This is the case of garment exports towards the EU: strict double-transformation requirements hamper garment markets shares in the EU, forcing Lesotho to rely on other markets. According to a diagnostic study of the economy, further support can be given to integrate local firms into the value chain (Millennium Challenge Corporation, 2018), as the benefits from foreign investment that are transmitted to the local economy are currently limited.

[3] The rank is affected by poor data availability in the scoring of electricity provision.

Figure 5 Rankings on Doing Business topics for Lesotho



Source: (The World Bank, 2019)

Limited financial services and credit constraints restrict the resources that local firms have at their disposal to invest and develop. Commercial banks lack the willingness to expose themselves to the high-risk environment that firms operate in, while the financial products that they offer are not tailored to the specific sectoral needs that producers have. Despite the return on equity of banks in Lesotho being the highest in the region, it is derived largely from liquid assets, rather than long-term loans to productive sectors (Government of Lesotho, 2018). On the other side of the credit market, local businesses often have long term capital needs but are unable to provide sufficient collateral. The limited level of financial literacy among firms' owners further inhibits access to finance. This mismatch between credit demand and supply results in high credit constrains for firms and low levels of investment. Going forward, the attraction of local entrepreneurs in business ventures and key investments must be improved and encouraged in order to increase the mobilisation of local capital.

2.2.2 Industrial estate experience

Lesotho's industrial strategy has included the development and provision of industrial estates with factory shells since 1975, which has facilitated a significant concentration of export-focussed garment manufacturers. The industrial estate programme became increasingly popular in the late 1990s as garment manufacturers sought alternative locations, such that nearly half (23) of industrial estate tenants were garment manufacturers by 2000. From 2003, the number of garment manufacturers operating in industrial estates has peaked at 60, about two-thirds of all tenants (Buro Happold Engineering Eunomix & DNA Economics, 2014). In the last 15 years, the nationality trends for new industrial estate investors has shifted from East Asia to South African companies.

LNDC currently owns eight industrial estates. Initial development of these estates has traditionally been funded by the Ministry of Trade and Industry, with infrastructure provided by respective ministries. Property costs are only partially recovered through ground and building rent charged to tenants, though at significantly subsidised rates. Infrastructure costs are waived for the first five years of industrial estate development and then paid by LNDC to responsible ministries.

LNDC's strategic plan includes the development of five commercial and industrial sites for development by private sector companies. New estates under development include an expansion of the existing Tikoe estate in Maseru and a new estate outside of Butha Buthe.[4]

Overall, the estates programme has been seen as a successful strategy to attract foreign investment for creating employment in Lesotho. The factory shell programme has been found to be the largest formal employer in Lesotho. A study of economic impacts in Lesotho's garments and textiles sector reported that around 40,000 jobs were supported from 2010-2015, accounting for the majority of all manufacturing jobs in the country (Buro Happold Engineering, Eunomix, & DNA Economics, 2015).

However, the development costs and rental subsidy policies underpinning the industrial estate programme to date creates an unsustainable model. As of March 2019, all but one industrial estate in LNDCs portfolio were profitable, not accounting for infrastructure development capital costs.[5] Previous analysis estimated that, inclusive of the cost of infrastructure capital costs, current rental rates would need to increase by 1,500% to break even (from c. M 30 to M 453/m^2/month) (Buro Happold Engineering Eunomix & DNA Economics, 2015).

Box 2 Summary of previous research/recommendations on developing Lesotho's industrial sector

Recommendations for the Pre-Feasibility Study for the Pilot Commercialisation of Industrial Sites in Lesotho included the following:

- Revise the LNDC structure to divide responsibilities between 1) an organisation responsible for investment promotion and economic development and 2) a separate Industrial Zones Development Corporation responsible for providing new factory shells and managing and operating industrial zones (through PPP arrangements);
- Determine PPP arrangements that could attract top tier firms' participant in factory shell provision and management on terms favourable to Lesotho's interests; and,
- Pilot a PPP arrangement for industrial estate development.

Following the findings of a 2017 governance study (Linpico & Koios Associates, 2017), LNDC has restructured its operations into separate Strategic Business Units for 1) investment and trade promotion, 2) property development and management and 3) development finance, all reporting to the LNDC CEO and board of directors.

In addition to this restructure, the Government of Lesotho introduced an Economic Labs programme, administered by the Prime Minister's office and the Ministry of Development Planning to facilitate strategic investment projects aligned with the economic development and diversification targets set out in NSDP II (Government of Lesotho, 2019b).

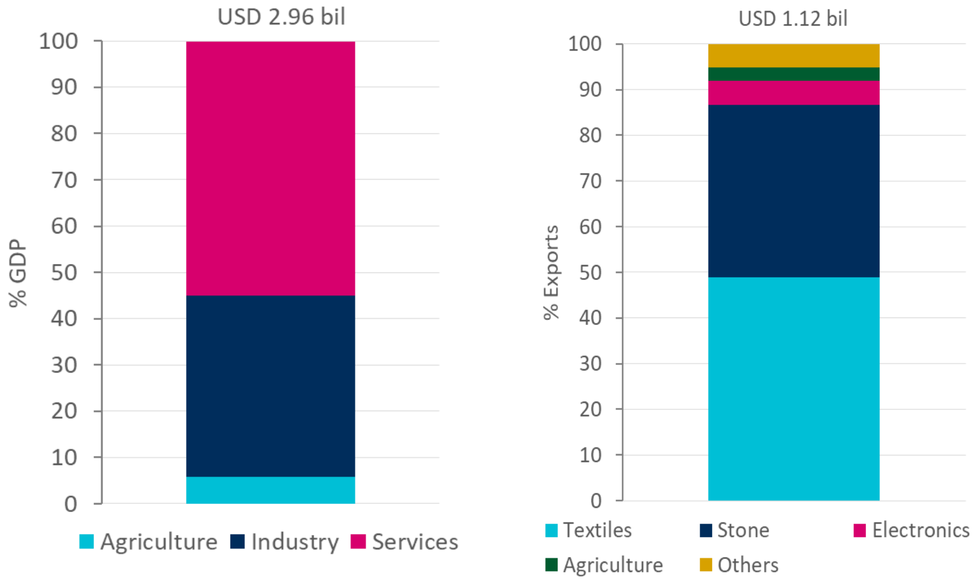
2.3 Opportunity sectors

Lesotho's production is currently concentrated in subsistence agriculture, apparel and textile, electrical machinery and mining. Product diversification and production scale up could help the country enhance its industrial potential and further exploit the benefits from trade agreements with foreign markets.

[4] Based on consultant team interview with LNDC Property Development and Management staff 05/09/19

[5] Based on Vivid Economics analysis of accounts provided by LNDC Property Development and Management division

Figure 6 Most of Lesotho's GDP comes from government services and exports are concentrated in few products



Source: Vivid Economics, based on data from UN Comtrade and cia.gov (2017)

2.3.1 Agriculture

Horticulture

To date, agricultural production has been limited to subsistence levels, accounting for less than 10% of GDP, but a shift towards commercial production could transform the sector (The World Bank, 2018). National studies identify four main productive sectors – agriculture, manufacturing, ICT and tourism, which are forecasted to contribute to national GDP by over M 14 billion in 2023. Among these four, agriculture is expected to become the largest contributing sector (46%), followed by manufacturing (34%) (Government of Lesotho, 2019a). Opportunities in agriculture include a transition towards commercial cultivation to supply both local and foreign markets.

Fruit and vegetable cultivation represent an important potential opportunity for Lesotho's industrial production, by leveraging the Kingdom's climate conditions and its proximity to South Africa. Currently 85% of the cultivated area is devoted to crop farming, in particular wheat (produced in the mountains), maize and sorghum (produced in lowlands). While Lesotho does not have a comparative advantage in cultivating cereals due to its mountainous terrain and poor soil, fruits and vegetables offer promising opportunities. The Kingdom imports 80% of fruits and vegetables consumed from South Africa, in particular potatoes, legumes, apples and pears. The most commonly planted vegetables are spinach, pumpkin and spaile,[6] while apples, peaches and apricots are the most common grown fruits (The World Bank, 2018). The difference in climate between Lesotho and the surrounding areas can provide an advantage from seasonal variation for several agricultural products with regional demand. This in turn may result into price premiums for the purchase of products that would not be found elsewhere at the same time. The Kingdom could also leverage different climate conditions to develop niche products that neighbouring countries are not able to grow. By expanding its production to

[6] A traditional green leaf vegetable.

South Africa and integrating its value chain, Lesotho could benefit from the skills, logistics, infrastructure and market size of the South African economy with respect to fruits and vegetables.

South Africa currently dominates the local agro-processing market, but the introduction of high-tech agriculture and the difference in climate conditions can make Lesotho well placed for a future development in the sector. As modern high-tech agriculture develops in the country, agro-processing can become a significant source of investment attraction and benefit from possible synergies with the existing regional value chain (Lesotho National Development Corporation, 2018). Currently, South African producers dominate the agro-processing industry within SACU, as they benefit from a wider spectrum of climatic regions, better access to input factors, a sophisticated logistics industry and a large local market demand. The largest cross-border flows consist of packaged goods from South Africa to the point of consumption in the lower demand countries. In the global context, the main advantages of the SACU region compared to international markets include the ability to deliver during off-season in the northern hemisphere and the opportunity to develop products for niche markets. Disadvantages include cost and quality of inputs, high costs of compliance with international food standards and competition from low cost producers and processors (The World Bank, 2014).

Thanks to its legislative framework and natural environment, Lesotho can support future growth in the industry of medicinal cannabis. The market for medical cannabis is relatively recent but growing quickly: it is estimated that by 2023 its total market value will be over USD 0.8 billion (Prohibition Partners, 2019a). Such market expansion is an opportunity for Lesotho's businesses. Competitive factors for the Kingdom include access to cost effective hydroelectricity, granted access to water supplies, globally competitive labour rates and a high-altitude environment with intense sunlight and low potential for insect infestation[7]. The legal framework does not represent an obstacle since legislation for legalisation was approved in 2008. This provides Lesotho with a further competitive advantage, since within the African continent only South Africa and Zimbabwe have legalised the use of medicinal cannabis. During the process of production set-up, it is key for local businesses to fully respect international standards in each phase of production, from cultivation and extraction to lab testing procedures.

Lesotho can scale-up the production of herbs and spices, thanks to its favourable climate conditions and abundant labour force. The African continent currently produces around 12% of the exported volume of spices in the world. Market demand is very strong, due to the increased use of spices and herbs in the food processing industry, and increasingly targets organic products coming from sustainable sources. The United States and Canada are the largest foreign market, followed by Europe. Lesotho is well placed to enter this market, given the favourable climate conditions and abundant labour force for the harvesting and processing phases. The spices that Lesotho could grow are chillies and paprika, currently sold as fresh vegetables. Production of herbs in the Kingdom to date happens at the micro to small level, typically as a side business on a farm. Basil, coriander, parsley, rosemary and thyme have the potential to sustain production scale-up in Lesotho (The Palladium Group, 2019).

Animal Products

Animal products have often been identified as a key sector where industrial clusters can help scale up production. Currently, Lesotho imports more than 80% of poultry products from South Africa to meet domestic demand (Government of Lesotho, 2018). South African suppliers in the poultry industry are highly vertically integrated and consequently do not facilitate the growth of local companies. In this context, poultry clusters could help Lesotho centralise infrastructure, feedstock and processing within the sector. Dairy products also provide opportunities for expansion; as a matter of fact, the Government of Lesotho has declared the dairy

[7] Information has been obtained from local producers.

subsector as a key priority for food security. Investment opportunities exist also in the leather subsector: car seat covers, footwear and accessories can be produced using locally sourced leather, while the low labour costs and the existing capacity in textiles make Lesotho a favourable site for relocation (The World Bank, 2014).

Being the second largest global producer of wool and mohair, textiles derived from animals represent an area of comparative advantage for Lesotho. These products are mainly exported in raw form through South Africa according to international standards and only a small percentage of production is used by local manufacturers to produce higher value products. Opportunities exist in the expansion of this production line, especially in the integration of a more complex value chain, such as the one for textiles, or in the scaling-up of current production.

Aquaculture

The abundance of Lesotho's water resources represents a further opportunity to attract investment from new horticulture companies into the country. The Kingdom's water basins can support not only a prosperous agricultural sector, but also the presence of fisheries. In that regard, previous analyses have highlighted the possibility to invest in aquaculture and export fish, such as trout, to the South African market as well as the EU and Japan.

Barriers to the expansion of the agricultural sector in Lesotho include access to finance and availability of infrastructure. Production within the agricultural sector is currently very limited, both in terms of quantities and varieties, and does not allow to fully meet local demand. Limited access to credit impedes farmers to scale up production. Such credit constraints are exacerbated in the agricultural sector by a lack of collateral amongst farmers. Cooperatives and community financing products may facilitate resource aggregation and some scale-up of production (The World Bank, 2018). Standards accreditation is a key step in expanding production internationally and export in developed countries, but most production facilities lack the resources to meet the minimum quality and hygiene requirements. Limited infrastructure poses several threats in the production phase, including inadequate irrigation facilities and cold storage, poor road conditions and lack of reliable transportation to market. Transport delays compromise product quality and the sector performance in terms of time-to-market. Insufficient land and water management, together with frequent rains and droughts, have led to degradation in many low land agricultural areas. This sets land restoration as a primary government objective for the commercial development of the agricultural sector.

Table 2 Opportunities in Agriculture

Sector	Subsector	Key markets	Notes
Agriculture	Dairy	Local market	Currently dominated by South African imports
Agriculture	Poultry	Local market	Currently dominated by South African imports
Agriculture	Raw fruits and vegetables	Local market, SACU	Comparative advantage in seasonality cycle
Agriculture	Agro-processing	Local Market, SACU	Advantage in development of niche products and seasonality cycle

Sector	Subsector	Key markets	Notes
Agriculture	Trout and other fisheries	South Africa, Japan, EU	Production takes place in the Highlands
Agriculture	Medical Cannabis	Canada	Lower selling prices compared to competitors
Agriculture	Herbs and spices	US, Europe, Japan, South Asia	Favourable climate and expanding export market

Source: Vivid Economics

2.3.2 Manufacturing

Textiles

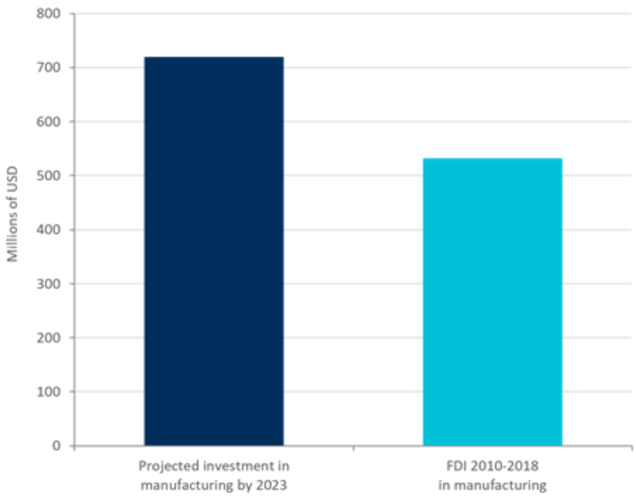
Lesotho's manufacturing sector has historically been dominated by the apparel industry. The Kingdom's low labour costs and preferential market access represent a comparative advantage in the sector and offer strong investment opportunities for foreign firms that focus on labour-intensive production processes, such as cut-make-trim. Investment in this sector is potentially exposed to low levels of value added and fragile trade relationships. Opportunities to diversify the manufacturing sector are important to develop the resiliency of the economy and generate greater benefits aligned with the national development objectives. By 2023 the manufacturing sector aims to attract USD 720 million of private investment (Government of Lesotho, 2019a). However, the cumulative amount of FDI directed towards manufacturing during the 2010-2018 period totalled around USD 532 million. Therefore, reaching the target set for 2023 represents a challenge for investment attraction.

Lesotho's exports of textile and apparel are mainly directed towards the United States and South Africa. Textile and apparel account for almost half of Lesotho's total exports. The US is the largest export market for Lesotho's textiles, with almost 52% of Lesotho's total textile exports directed there in 2017. These exports represented a limited fraction (0.14%) of the US textile imports in that year, as the main suppliers are located in China, Vietnam and India. Another 40% of textile exports from Lesotho go to South Africa. Lesotho, together with Eswatini, is the largest African supplier of textiles to South Africa (3.72%) but the highest shares are held by China, India and Vietnam which collectively cover more than 60% of South Africa's textile import market. [8]

Recent developments in trade policy may undermine the country's current market shares in the textile and apparel subsectors. In particular, the expiration of the US-Africa AGOA trade agreement due in 2025 may disrupt trade flows to the US. Moreover, the expiration of the Multi-Fiber Arrangement (MFA) in 2004 has resulted in the lift of quotas previously imposed through the Arrangement on a number of developing countries' exports to developed regions. This allowed Asiatic firms to compete in markets such as the US at lower costs than before, which in turn raised a significant threat to Lesotho's competitive position in the sector.

[8] Based on UN COMTRADE data

Figure 7 Total FDI in manufacturing in the 2010-2018 period is lower than projected investment by 2023



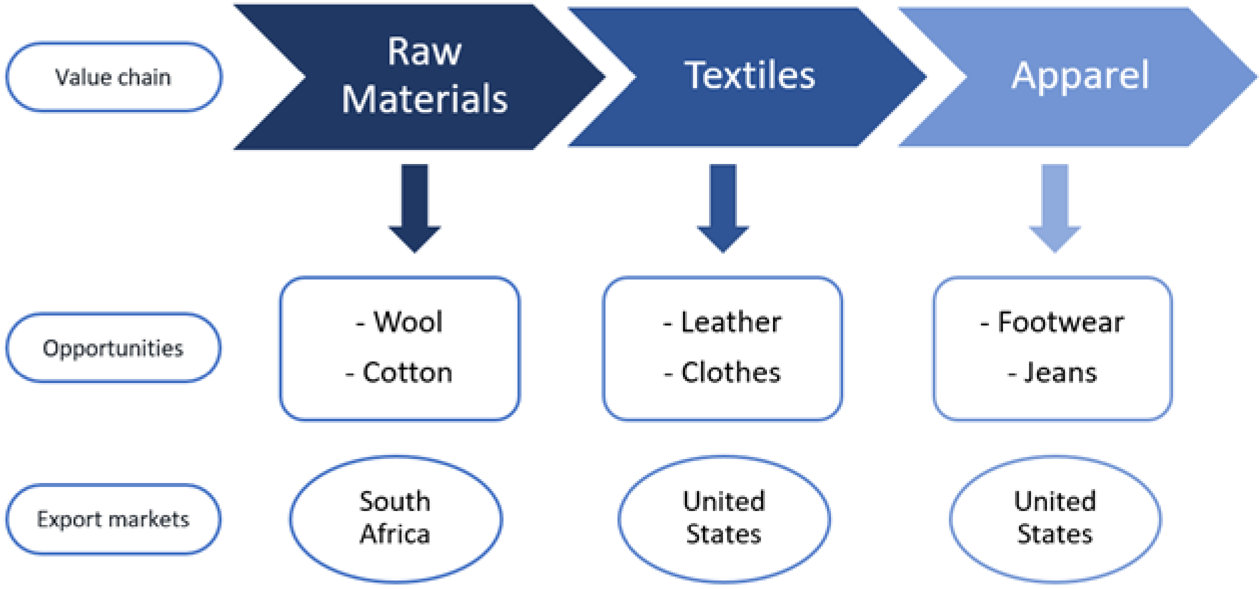
Source: Vivid Economics, based on data from Lesotho Economic Lab and FDI Markets

Value-chain integration represents an important opportunity for apparel and textiles but benefits for the local economy vary between South African and Taiwanese investors. Previous studies have identified the South-African based value chain in the apparel sector to offer greater potential for technology and skill transfers to local businesses; instead, Taiwanese investors seem to be more interested in Lesotho's preferential access to a number of big consumer markets and the consequent opportunities for cost containment, therefore posing little effort into increasing the value and skills of local firms (Morris, Staritz, & Barnes, 2011).

Lesotho takes part into a very limited portion of the textile value chain, but opportunities exist for value chain deepening and widening. Currently, Lesotho is involved in the product transformation phase by exploiting its low-cost labour force. However, vertical integration within this subsector could unlock high potential for the country's industrial perspectives. Studies suggest that the production of raw materials could be done at a local level, instead of relying on imports from Asia (Government of Lesotho, 2018). Moreover, the local textile industry currently consumes vast quantities of imported pieces of packaging, which could instead be produced locally and integrated in the local value chain. The process of value chain deepening not only allows the country to take over more stages of the production line, but it also significantly reduces the lead times.

Significant opportunities exist to diversify the destinations of Lesotho's apparel exports, which have implications for the approach to investment attraction. Lesotho currently exports most of its garment products to the United States, taking advantage of the AGOA trade agreement. Since the future of such agreement is not certain yet, it is important for Lesotho to explore new products and new markets within this value chain. Lesotho's proximal location and integrated logistical routes to South Africa present opportunities to access a large consumer market. Tighter links between Lesotho and South Africa within the garment value chain could allow South African retailers to benefit from Lesotho's expertise in the textile sector, while maintaining proximity to their business and limiting time-to-market.

Figure 8 Garment Value Chain and Opportunities



Source: Vivid Economics

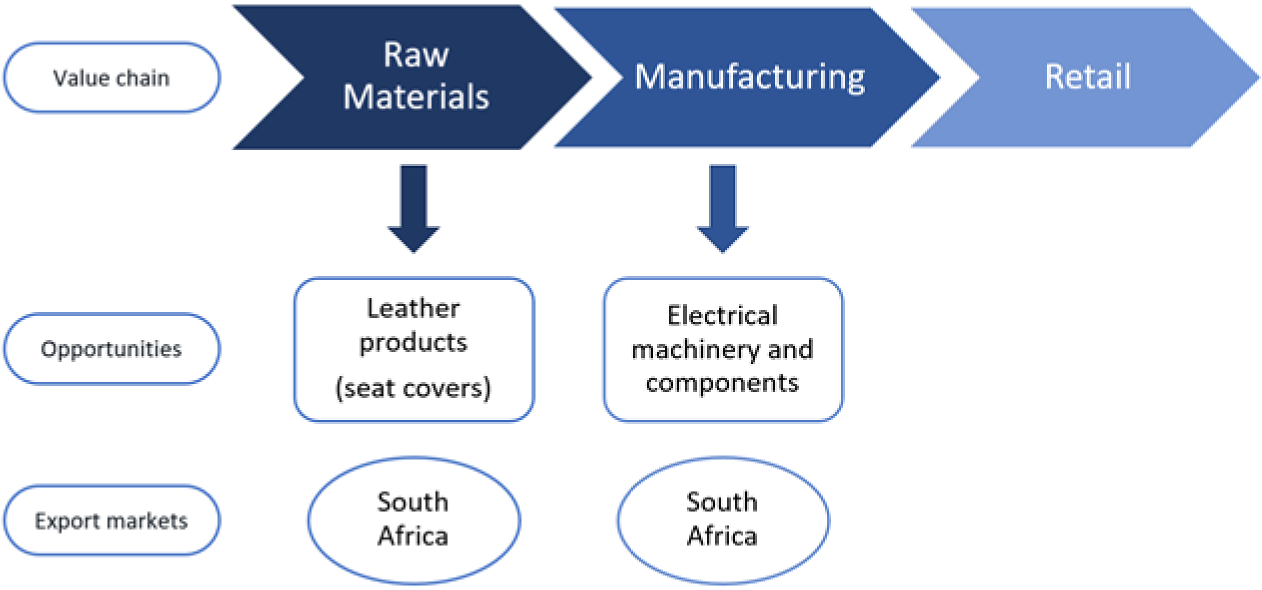
Automotive components

Proximity with South Africa can be beneficial for Lesotho not only for the potential synergies with the textile sector, but also for the linkages with the South African automotive industry. In this regard, Lesotho could scale up its production of leather products, such as seat covers, to complement the needs of the South African supply chain. The South African automotive sector has developed an extended local suppliers base made of around 350 component manufacturers within the country (The World Bank, 2014). The final products represent around 8.15% of South Africa's exports every year.[9] Major importers of vehicles coming from South Africa include Germany, the UK, Belgium and Japan. Given the global nature of the automotive industry in South Africa, this opportunity may create a large market for Lesotho's products.

The large production capacity of the South African automotive sector can represent an opportunity for Lesotho to expand the production of electronic components for cars. The subsector of electronic components may offer synergies with the automotive sector: in 2017 Lesotho exported more than USD 60 million worth of electronic components and machinery (i.e. 5.38% of total exports),[10] highlighting a considerable production capacity. Stronger ties with the South African automotive industry can help Lesotho expand production and strengthen its trade balance.

[9] Based on UN COMTRADE data
[10] Based on UN COMTRADE data

Figure 9 Automotive Value Chain and Opportunities



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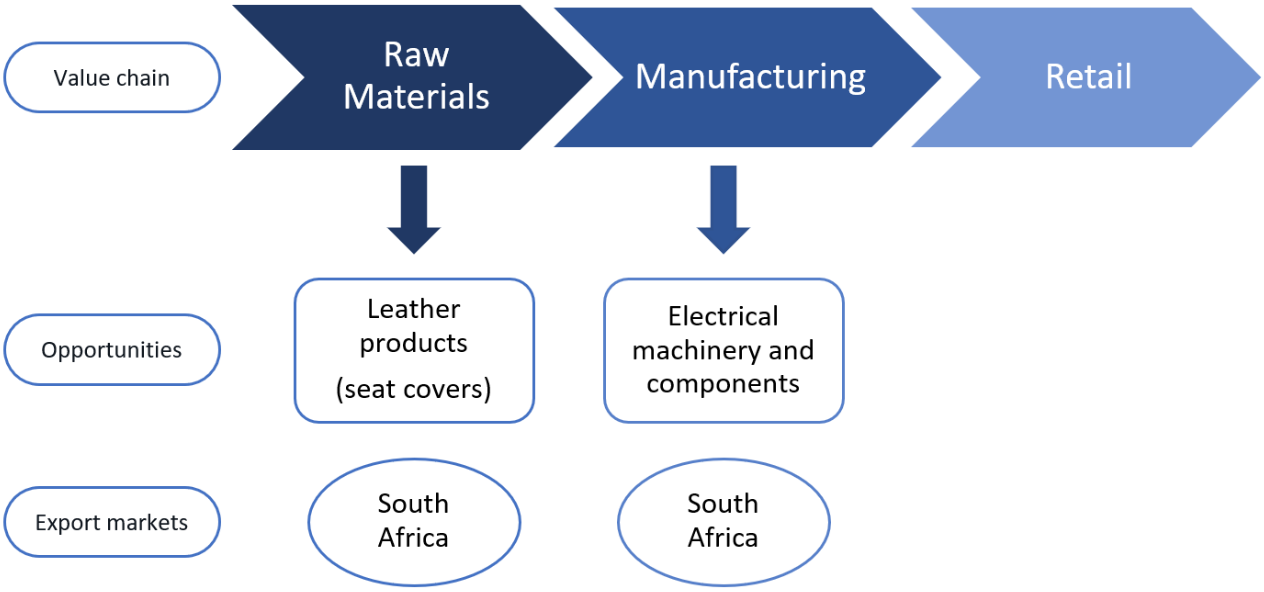
Source: Vivid Economics

Figure 7 Automotive Value Chain and Opportunities



Source: Vivid Economics

Natural resources

Lesotho's endowment of natural resources includes products of mining, such as sandstone and clay. These materials are especially useful in the construction sector, as they can provide sandstone and bricks to develop new infrastructure. Several studies have identified the mining and construction sectors as important growth accelerators for Lesotho: Recent construction projects, such as the LHWP II, have demonstrated the success of construction opportunities in the past, while the mining sector has recently witnessed a surge in exports, especially regarding the production of diamonds.

The country's abundant water resources have led many previous studies to point to the water bottling business as a subsector with growth potential. Lesotho exports most of its water resources to South Africa but spends an estimated USD 5 million a year in bottled water imports. This suggests that local entrepreneurs have still not taken full advantage of the available local and foreign markets for bottled water (Government of Lesotho, 2018).

Table 3 Opportunities in Manufacturing

Sector	Subsector	Key markets	Notes
Manufacturing	Textiles	SACU; United States	Potential in value chain development and production scale-up
Manufacturing	Apparel	SACU, United States	Regional markets may increase opportunities in the future
Manufacturing	Water bottling	SACU	Leverage abundant water resources
Manufacturing	Leather products	South Africa	Possible integrations with the South African automotive industry
Manufacturing	Packaging material	Local market	Integration in the local textile value chain
Manufacturing	Electrical Machinery	SACU	Possible integrations with the South African automotive industry

Source: Vivid Economics

2.3.3 Other sectors: Services

Lesotho is not currently equipped with a thriving ICT sector, but many opportunities lie ahead, especially when connected to the agriculture and manufacturing sectors. The expansion of digital services can encompass several areas: from providing market information to local businesses, to streamlining government procedures and reducing red tape. Opportunities in ICT should also be considered when they can support the primary ones listed in the previous sections. The development of smart agriculture could enable farmers to enhance their productivity levels, while the inclusion of ICT services in the manufacturing production processes could help better integrate the value chain and expand in the online shopping area. These opportunities heavily depend on Lesotho's ability to involve private investors in the digitization process, as well as on the involvement of local universities and institutions of higher learning that can enhance the country's development of new technologies.

ICT development in Lesotho is still constrained by many barriers. First, the majority of businesses is unaware of the potential that technology has in enhancing productivity levels. Moreover, most of the population still does not use the internet or lacks the skills to do that. A partial reason for that resides in the high prices and low penetration levels of the electricity grid in Lesotho, which limits the further development of ICT systems. The development of functioning ICT infrastructure in Lesotho could be used to locally support businesses such as call centres and digital services for South Africa.

Lesotho's tourism sector is in its early stages of development, but the abundance of natural heritage points towards high growth potential. The Kingdom recently established the Lesotho Tourism Development Corporation (LTDC) with the mandate of developing and promoting tourism as a key contributor to the country's economy. So far LTDC has earmarked a total of nine tourism destination areas around the country, which await further development. Looking forward, the development of a thriving tourism sector in Lesotho will depend on the country's ability to preserve its natural environment from both industrial development and land degradation. Moreover, significant barriers to the sector's growth and development, namely low investment and lack of proper infrastructure, will need to be tackled.[11]

The Kingdom's high reliance on trade relationships with other countries provides scope for the development of a broad logistics services sector. Creating an efficient network of shipment in and out of the country represents an incentive for firms to invest in Lesotho (Government of Lesotho, 2018). Building such a network requires investment in heavy infrastructure and transport services. Due to Lesotho's geographical location, further challenges to the sector's development are represented by its landlocked position, which does not allow for direct access to seaports, and its mountainous terrain, which represents a natural barrier to transportation.

The creation of a developed financial services sector can significantly foster investment attraction, but so far this is still a distant target for Lesotho. Given the scarce level of development of the Kingdom's financial sector, most of the companies operating in Lesotho today resort to services from abroad. However, a deep and liquid financial market could represent a further incentive for firms to relocate to Lesotho. Moreover, services provided at the local level could be much more tailored to the area's specific characteristics and needs (Government of Lesotho, 2018).

[11] https://www.afdb.org/fileadmin/uploads/afdb/Documents/Procurement/Project-related-Procurement/EOI_%E2%80%93_Lesotho_-_Feasibility_Studies_of_Potential_Projects_in_the_Tourism_Sector_to_Attract_Investment_-_Economic_Diversification_Support_Project.pdf

Table 4 Key sector opportunities identified in desk review

Sector	Subsector	Current Investment opportunities(Government of Lesotho, 2019b)	Barriers	Clustering benefits	Policy development requirements	Key markets	Notes
Agriculture	Dairy	Mafeteng, Leribe, Mazenod, Butha Buthe, Matsieng, Teyateyaneng	Poor coordination and collection	Animal imports		Local market	Currently dominated by South African imports
Agriculture	Poultry	Leribe, Berea	Lack of local solutions for hatchery and feed services	Animal imports, shared facilities (abattoir)		Local market	Currently dominated by South African imports
Agriculture	Raw fruits and vegetables	Leribe, Butha Buthe, Berea, Maseru	Food standards, limited arable land	Equipment (pesticides, cold storage facilities, packaging), light truck		Local market, SACU	Comparative advantage in seasonality cycle
Agriculture	Agro-processing	King Moshoeshoe I International Airport SEZ; Mafeteng	Commercial scale, standards, high-tech facilities	Agricultural and packaging industries		Local market, SACU	Advantage in development of niche products and seasonality cycle
Agriculture	Trout and other fisheries	Katse dam, Mohale dam		Solar-powered facilities (aquaponics, vegetables)		South Africa, Japan, EU	Production takes place in the Highlands
Agriculture	Medical cannabis	Maseru, Mafeteng	Standards, licenses, machinery	Pads, greenhouses, drying and milling	Infrastructure investment (facilities, water, electricity)	Canada	Lower selling prices compared to competitors

Sector	Subsector	Current Investment opportunities(Government of Lesotho, 2019b)	Barriers	Clustering benefits	Policy development requirements	Key markets	Notes
Agriculture	Herbs and spices	Maseru	Standards; lack of aggregation facilities	Drying and milling phases	Financial offers and grants	US, Europe, Japan, South Asia	Favourable climate and expanding export market
Agriculture	Red meat		Sanitary standards	Linkages with hide and skin processing	Change in import quality	SA, US, China	Possible expansion to grade A and B meat
Manufacturing	Textiles		High reliance on FDI, cheaper imported goods	Cluster with apparel production	AGOA extension	SACU; United States	Potential in value chain development and production scale-up
Manufacturing	Apparel	Maseru, Leribe	High reliance on FDI, factory shells	Cluster with textile production	AGOA extension	SACU, United States	Regional markets may increase opportunities in the future
Manufacturing	Water bottling	Mafeteng	Standards	Testing facilities, plastic making	longer-term water use permits	SACU	Leverage abundant pure water resources
Manufacturing	Leather products	Maseru	Poor infrastructure and transport services for value chain integration	Use hides and skins from local meat industry; textile skills.		South Africa	Possible integrations with the South African automotive industry
Manufacturing	Packaging material	Maseru, Tau Tsehla Agri-Industrial Zone (Mafeteng)	Imported raw materials	Links with garments and food industries,		Local market	Integration in the local textile and food value chain

Sector	**Subsector**	**Current Investment opportunities**(Government of Lesotho, 2019b)	**Barriers**	**Clustering benefits**	**Policy development requirements**	**Key markets**	**Notes**
				solar power, electrical			
Manufacturing	Electrical Machinery	Maseru	Lack of advanced manufacturing equipment	Automotive and plastic (high-tech plastic injection moulding) industries	Access to finance	SACU	Possible integrations with the South African automotive industry

Source: Vivid Economics

2.4 Sector SWOT analysis

This section provides some key reflections on the opportunities identified in section 2.3, summarised in the form of subsector Strengths, Weaknesses, Opportunities and Threats (SWOT) analyses. The SWOT analyses consider regional supply chain opportunities in particular and are oriented to the specific development opportunities that may be created through the establishment of SEZs in Lesotho. The sectors discussed below are not meant to provide a complete list of opportunities suitable for SEZs in Lesotho, but rather supplement analysis and recommendations included elsewhere in this report.

2.4.1 Agriculture: Livestock and animal products

Opportunities related to animal products could benefit from preferential market access as well as significant local demand. Importing fish and meat to the EU, as well as Mohair to the US would leverage the dual benefits of high tariffs and large markets. Local demand for pork, poultry and dairy is currently met by high levels of imports. These products could be developed alongside those intended for export to leverage shared infrastructure including feedstock and processing facilities.

Barriers to achieving these opportunities include high standards for export markets and a lack of infrastructure including high-quality agricultural land and processing/packaging facilities. Specifically, weaknesses include:

- private and official sanitary/phytosanitary requirements are a key barrier to selling abroad. SEZs could address concerns around animal disease through centralised stock management, monitoring and treatment as well as shared certification facilities;
- a shortage of processing and marketing infrastructure exists to bring local products to market and establish their quality (Food and Agriculture Organization of the United Nations, 2018). SEZs could provide these facilities for a cluster of businesses, distributing the costs across a number of users;
- there is a lack of parent stock for breeding in the country and feed is extremely expensive (for both livestock and fish farming); and,
- a lack of education and skills has resulted in improper rangeland management, which exacerbates and causes issues including poor soil quality and expensive animal feed. In fact, Lesotho’s soil and water, two of its most important national assets, are experiencing rampant degradation in all agro-ecological zones. Massive losses of topsoil are driving declines in soil fertility and reducing the productivity of both croplands and rangelands. Land degradation presents significant risks to animal grazing. Livestock are the biggest users of rangeland resources and these resources need to be complemented with the production of livestock fodder in order to relieve pressure from the overgrazed areas. Marginal fields that are progressively producing lower yields are good candidates for the perennial production of animal fodder (Food and Agriculture Organization of the United Nations, 2018).

Lesotho could scale up its production to include leather inputs for seat covers or other inputs into South Africa’s automotive industry. Integration by Lesotho into the South African automotive value chain has the potential to create significant revenue and jobs for Lesotho’s economy. Statistics South Africa indicate that the South African motor vehicle industry grew 4.9% in 2018. This was the largest growth sector in the manufacturing economy in 2018 and contributed 0.4% to total manufacturing growth. Even more promising for Lesotho enterprises, factories involved in the production of vehicle accessories enjoyed a 9.2% rise in economic activity. While the South African automotive industry is a marginal international player, the industry is important for the local economy and there is a niche opportunity for leather materials from Lesotho in the industry. In addition, the South African government is slowly reducing tariffs, exposing local firms to global competitiveness more acutely (Barnes, Black, Comrie, & Hatogh, 2018).

Table 4: SWOT Summary, Fish and Animal Products

Strengths	Opportunities
• Established wool and mohair exporter • International market for animal hair and related apparel products • Existing capacity in textiles • Lower tariffs, especially across dairy, fish and animal hair for the US, EU and South African markets. • Existing leather sub-sector around textiles • Considerable capacity in the production of electrical components and machinery • Lower tariffs on Leather in the USA and South Africa	• High domestic demand for pigs and poultry • High domestic demand for dairy and associated products • Expansion of textile manufacture into leather using locally sourced material • Development in water sector increase the attractiveness of fisheries and aquaculture • Competitive market in South Africa (low barriers to entry) • Large, growing South African market (especially for poultry) • Proximity to South Africa provides opportunity to integrate into large automotive value chain • Growth in automotive accessories and the South African automotive industry at large presents an opportunity for leather inputs
Weaknesses	**Threats**
• Lack of parent stock • Expensive feed • Shortage of processing and marketing infrastructure • Improper rangeland management and poor soil quality • Poor livestock productivity • Poor product quality • Lack of information around international markets • Low productivity • Lack of skills • Obsolete technology • Weak linkages with value chain	• Disease outbreaks • Climate change and severe weather • Currency volatility • Stiff competition from South African producers • Severe weather leading to animal disease • Demand shocks • Competitive local and global market

Source: DNA Economics based on FAO (2017,2018); Barnes, Black, Comrie, & Hatogh (2018); World Bank (2018)

2.4.2 Agriculture: Horticulture

Lesotho's climate offers a seasonal advantage in the regional fruit and vegetable market. While Lesotho does not enjoy a comparative advantage for agricultural products per se (on account of poor soil quality among others), differences in climate between Lesotho and the surrounding areas provide a seasonal advantage for agricultural products with regional demand. Lesotho's climate is favourable to production of many vegetables and deciduous fruits. Thanks to the country's high altitude, Lesotho's fruit can be harvested two to three weeks earlier than that in South Africa's Western Cape province (the main centre for fruit production), resulting in price premiums (World Bank, 2018).

The horticultural sector in South Africa is large, comprising over R 60 billion in 2016 (Statistics South Africa, 2017). This represents a significant opportunity to integrate into the fruit, vegetable and crop processing sector in order to capitalise on a large, profitable sector of the South African economy. The sector is competitive, with the largest 100 companies enjoying a market share of less than 30% in 2016. Figure 10 below indicates the concentration ratio in the South African agriculture sector (BFAP, 2017).

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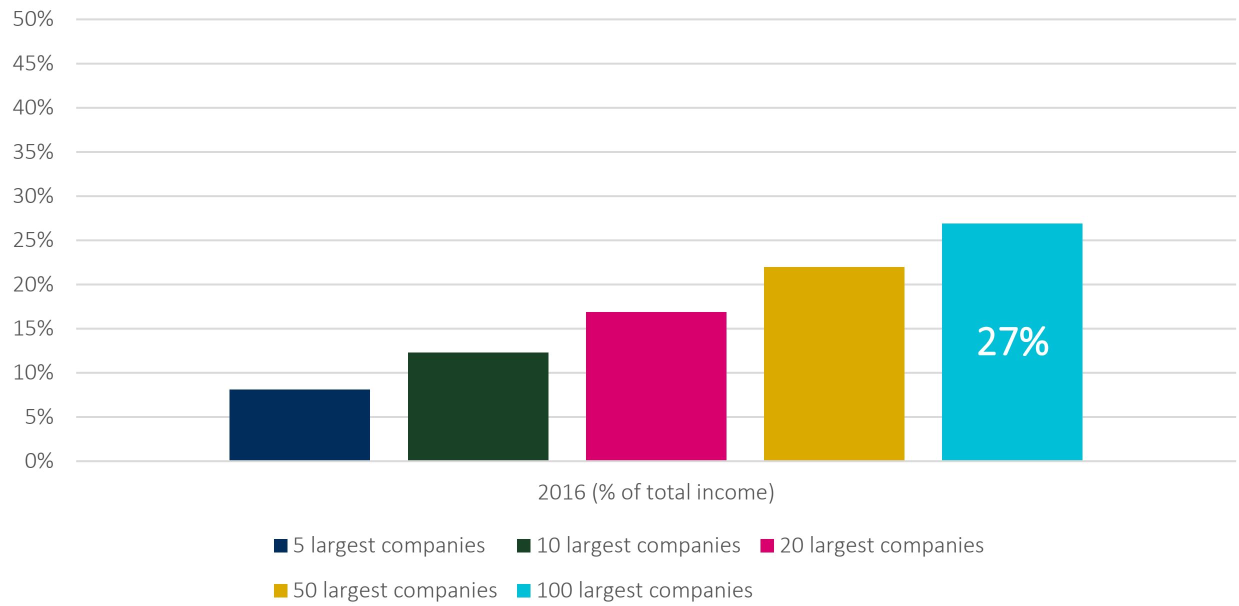
Figure 10: The South African Agriculture Sector is highly distributed



Source: DNA Economics, Stats SA (2017)

Challenges faced in the horticulture subsector relate to the security and quality of land. The World Bank notes that 'the most significant challenges faced by the sector are lack of a functioning land market (only 232 farmers have land titles) and irrigation, poor productivity of smallholders, and weak linkages within the value chain' (World Bank, 2018). Soil erosion and land quality also limits the potential of existing agricultural land, without further rehabilitation efforts. Given South Africa's similar location and climate, there is potentially legalisation of medical cannabis in South Africa presents a significant threat to Lesotho's comparative advantage for that particular industry (Bloomer, 2019).

Table 5: SWOT Summary; Fruit, vegetable and crop processing

Strengths	Opportunities
• Significant land devoted to farming • Significant local and international demand • Seasonal advantage to fulfil demand • Significant tariff advantage, especially for products higher along the value chain (prepared foods)	• Proximity to South Africa provides opportunity to integrate into large value chain • High imports provide opportunity to supply local market • Competitive market in South Africa (low barriers to entry) • Large South African market
Weaknesses	**Threats**
• Poor soil quality • Lack of packing infrastructure and transport services • Weak land market • Poor water infrastructure • Poor productivity for smallholders	• Severe weather exacerbated by climate change • Currency volatility • Competitive market in South Africa (stiff competition) • Potential legalisation of medical cannabis cultivation in South Africa

• Weak linkages with value chain	

Source: DNA Economics, FAO (2017,2018), World Bank (2018)

2.4.3 Manufacturing: Packaging

Manufacturing opportunities in the packaging subsector are likely to be related to the context of integrated processing operations at SEZs, while Lesotho's water supply presents an outright export opportunity.

- zone systems such as those developed in agroindustrial and agroprocessing parks provide an opportunity to integrate packaging as a service to support the primary export products.
- Lesotho has abundant water and it is already a major bulk exporter. The country currently imports about 5 million US dollars' worth of bottled water each year (Mokhethi, 2018). This indicates a demand for bottled water in the Kingdom; and,
- despite increased fruit and vegetable production in Lesotho – thanks to investments in greenhouses and other infrastructure – the emergence of value-added services has been slow. A lack of commercial processing facilities presents an opportunity for packagers in Lesotho (World Bank, 2018). Integration by packaging suppliers into local textile and food value chains will be necessary for the future growth of the sector.

Table 6: SWOT Summary, Packaging

Strengths	Opportunities
• Local packaging manufacture already taking place • Increasing packaging exports, decreasing packaging imports • Extensive water resources • Lower comparable tariffs across paper in the USA and plastics in the EU and South Africa	• High local demand for packaging • Value chains exist around textiles and food industries, which can be leveraged with good strategy and execution
Weaknesses	**Threats**
• Poor water infrastructure, factories facing water shortages • High export costs • Lack of price completeness • Lack of brand awareness	• Low international price • Currency volatility • Change in international demand • High market concentration in South Africa • Stagnant growth in South Africa

Source: DNA Economics, FAO (2017,2018), World Bank (2018)

2.4.4 Manufacturing: Pharmaceutical products

Given the low level of preferential access for pharmaceutical products, opportunities for Lesotho may be limited to niche sectors such as medical cannabis. In a regional context, South Africa has begun the process of decriminalising the use of cannabis and the relevant health regulator has begun issuing licences for the commercial cultivation of cannabis for medicinal use (Medical Academic, 2019). Given that Lesotho already has a formal and active cannabis industry, this suggests the potential for Lesotho-based firms to export to a new, close and potentially fast-growing market. This is highlighted by the fact that a publicly listed company in

South Africa has recently made a significant investment in Lesotho's cannabis market, purchasing a controlling stake in a Lesotho-based cannabis grower and manufacturer for more than R 70 million (News24, 2019).

The South African market is approximately R 45 billion, making up 0.4% of global value and 1% of global volume. The compound annual growth rate is estimated at 4.5% between 2015 and 2020. Domestic manufacturers produce almost exclusively generic products and are import dependent for their manufacturing. The local manufacturing capabilities in niche pharmaceutical sectors in South Africa could be leveraged in order to access pharmaceutical skills and serve a growing international and African market. It is also estimated that the niche medicinal cannabis market in South Africa could exceed USD 650 million by 2023 (Prohibition Partners, 2019b). Two local, established South Africa pharmaceutical manufactures (Aspen and Adcock Ingram, with 16.2% and 9% South African market share respectively) dominate domestic production, and this may present a significant competitive challenge to new entrants.

There may be specific barriers to entry for pharmaceutical products in the South African market. A permit or certificate is required from the South African Director General: National Heath and Population Development for pharmaceutical product importers. This restriction is controlled by the Medical Dental and Supplementary Health Service Act (no. 56, 1974), the Health Act (No. 63, 1977) and the Animal Health Act (No. 35, 1984). There are also restrictions which prevent the import of pharmaceutical goods through certain ports – with 11 ports being valid entry points (CMA CGM, 2014). None of these trade posts share a border with Lesotho. The implication is that manufacturers of pharmaceuticals in Lesotho would need to direct export through a South African international airport. This could increase the transport costs for local firms and making exporting pharmaceutical products more challenging.

Table 7: SWOT Summary; Pharmaceutical Manufacture

Strengths	Opportunities
• Some qualified personnel • Strong domestic demand • Potential first-mover opportunities in niche industries (e.g. medicinal cannabis)	• No major players in Lesotho • Major demand for pharmaceutical products especially HIV, which the government would likely support given the health crisis • High South African demand
Weaknesses	**Threats**
• Weak legislative framework • Lack of access to finance • High capital costs • Lack of industry knowhow • Not enough qualified pharmacists • No tariff advantage over other suppliers • Some barriers to entry into South African market (may limitability to trade to South Africa)	• Imports from South African and international manufacturers • Expensive inputs • Highly concentrated production market in South Africa

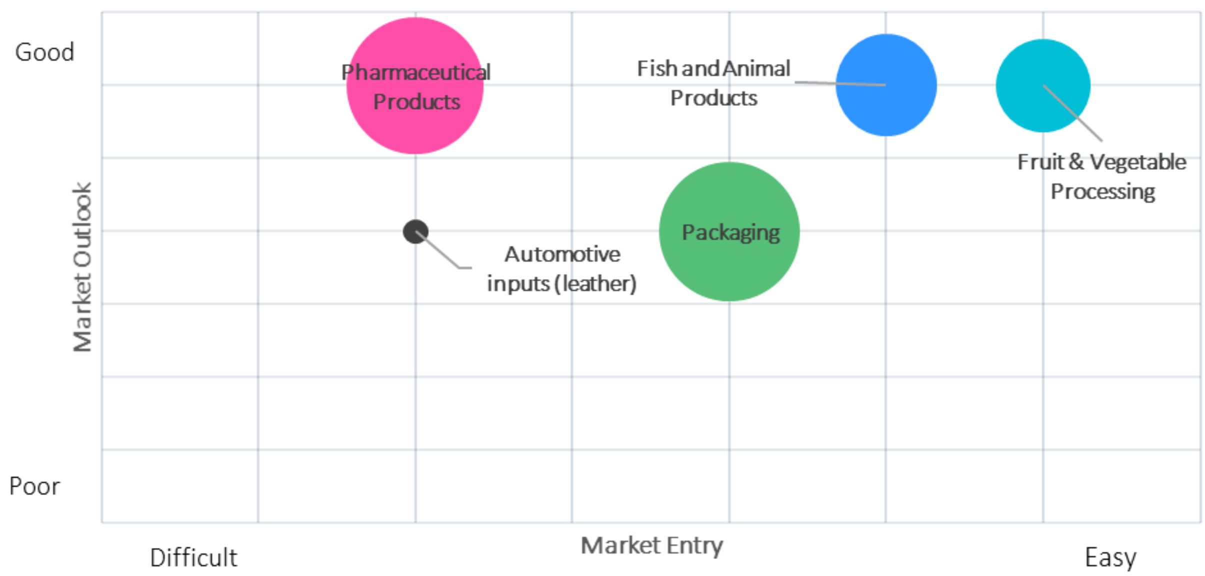
Source: DNA Economics, Mothibe (2014)

2.4.5 Summary assessment

In an attempt to summarise the discussion above and synthesise a concise response, Figure 11 presents a tentative opportunity matrix for Lesotho-based firms. The matrix makes use of three variables to illustrate the most favourable opportunities. On the 'x-axis', barriers to entry are assessed. In order to assess the ease (of difficulty) of market entry, data around market concentration was used. A more concentrated market indicates more barriers to entry. The 'y-axis' attempts to quantify the qualitative discussion above; and provide an indication around the market prospects around various industries in South Africa and Lesotho. Conditions including regulatory environment and projected industry growth determine the state of the market outlook. The last variable in the matrix concerns the size of each industry. Bubble size provides an illustration of market sizes across each industry. The larger bubbles indicate larger markets. In order to determine market size, imports of related products were aggregated across the United States, the European Union and South Africa.

The figure illustrates two interesting opportunities for Lesotho firms, both in agriculture. While the market size of the pharmaceutical and packaging industries is large, market outlook and market entry are not entirely favourable. The market for automotive inputs is small and there are some challenges to market entry. However, there are linkages between this market and the market for fish and animal products. Both the fish and animal product sector as well as the fruit and veg sector have favourable market outlooks (thanks to growing South African demand and international export markets), and relatively low barriers to entry – in comparison to other assessed sectors.

Figure 11: Opportunity matrix for Lesotho firms



Source: DNA Economics

3 SEZ global experience and lessons

This section sets out the role of special economic zones (SEZs), trends related to SEZs globally and in Africa, and best practice across SEZ regimes.

3.1 The role of special economic zones

Special economic zones are geographically demarcated areas designed to attract economic activity through a range of fiscal, regulatory and infrastructure related incentives. In 2018, 5,400 SEZs were operating in 148 countries. Under current proposals at least 500 more zones are expected to open in the near future (United Nations Conference on Trade and Development, 2019b). They are typically deployed as a tool for industrial policy and investment promotion due to their ability to overcome barriers to investment in the wider economy and concentrate marketing efforts. However, their success is not guaranteed, with numerous zones failing to attract investment or deliver benefits.

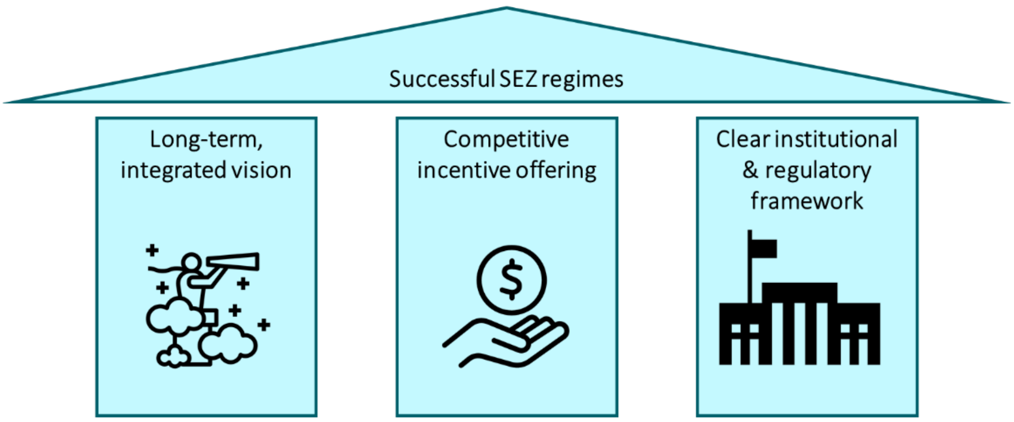
Zones are often a cornerstone of industrial policy and a tool for meeting national policy objectives, but their success is not inevitable. Successful SEZs have served as a cornerstone of industrial policy in countries which otherwise failed to attract investment due to an unfavourable investment climate. Shenzhen SEZ in China, for example, developed the local region from a textile-focused economy to a hot-spot for high-tech manufacturing. However, there are also countless examples of zones which have failed to deliver short-term benefits, such as FDI or employment creation. Even zones which have been able to create jobs have often failed to stimulate spill overs on the local economy, leaving little lasting impact on a country's development (United Nations Conference on Trade and Development, 2019b).

Experience shows that to be successful, SEZ regimes will require:

- **a long-term vision** aligned with the wider economic strategy;
- **a clear institutional and regulatory framework**, often with a dedicated SEZ regulator, developer, operator and set of SEZ laws; and,
- **a competitive incentive offering**, including a mixture of physical infrastructure, tax relief and business facilitation services (COMCEC, 2017).

These pillars of zone success are illustrated in Figure 12 and detailed in the following sections.

Figure 12 Pillars of SEZ success



Source: Vivid Economics

National governments facilitate the development of SEZs to meet a range of short and long-term objectives. Most commonly, national governments encourage SEZs as a mechanism for:

- employment creation: a direct benefit of SEZs is their ability to provide jobs, through the attraction of labour-intensive industries and creation of supply chain linkages between foreign and local firms. As a result of this ability, zones are also often used to meet another objective, of reducing regional inequality;
- attracting foreign investment: when supported by clear, government commitments and an attractive incentive offering, SEZs can serve as high-profile investment locations that are easier to brand and sell to potential investors. Experience shows that the clearer labelling of zone benefits and concerted promotion efforts helps to increase FDI inflows to a country, above the status quo;
- export-led economic growth and income generation: SEZs can increase the competitiveness of export-focused businesses by providing a regulatory regime that decreases the fiscal and administrative burden of trade. They have therefore been used as vehicles for increasing the share of exports captured by an economy, leading to a boost in national economic growth and tax revenues;
- diversification and upgrading towards higher value-add industries: by attracting investment in new, increasingly complex activities SEZs can catalyse a structural shift in the economy. This process can occur through knowledge and technology transfers between foreign and local firms; clustering and agglomeration effects, which increases the competitiveness of nearby firms; and, policies that increase the reliance on the local supply chain outside of the zone; and,
- piloting new, experimental policies: through the creation of a distinct regulatory regime, SEZs can also serve as a testing bed for new policies. This use is most prevalent in countries which are large or face high barriers to proposing legal changes, such as China or the UAE (Akinci & Farole, 2014).

3.2 Zone typologies

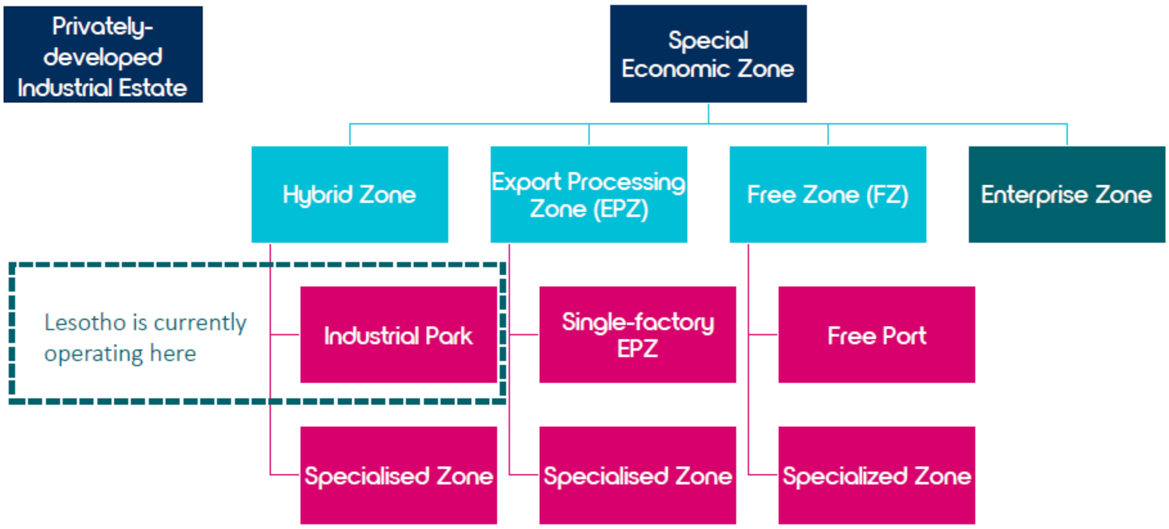
According to their objectives and dominant type of economic activity, SEZs will fall under four main categories: Hybrid Zones, Export Processing Zones (EPZs), Free Zones (FZs) and Enterprise Zones (EZs). The first modern SEZ was set up in Shannon, Ireland in 1959. Since then, a variety of different zone setups have evolved. Whilst these zones typically go by many different names, such as special economic zones, freeports, free zones, industrial parks, and innovation centres, these varieties all reflect four archetypal SEZs, illustrated in Figure 6. These are:

- Hybrid Zones are host to businesses that both export and sell into the domestic market. They are typically sub-divided into a general zone and a separate one reserved for export-oriented enterprises, or alternatively offer differing incentives. Common objectives include creating attracting FDI, creating linkages with the wider economy;
- Export Processing Zones (EPZs) are industrial estates aimed primarily at activities directed to foreign markets. A subtype of EPZ is the Single Factory EPZ, which provides incentives to individual enterprises regardless of location. Common objectives include attracting FDI, export-led economic growth;
- Free Zones (FZs) are fenced-in, duty-free areas, offering warehousing, storage, and distribution facilities for trade, trans-shipment, and re-export operations. A subtype of the FZ is the Free Port which typically encompass much larger areas and accommodate all types of activities, including tourism and retail sales and on-site residence. Common objectives include employment creation and attraction of foreign currency;
- Enterprise Zones (EZs) are intended to revitalize distressed urban or rural areas through the provision of tax incentives and financial grants. Common objectives include reducing regional inequalities.

Specialised Zones can exist as a subtype across all of these zone typologies, defined by the presence of a sector or activity focus. They can include agri-parks, innovation centres, petrochemical zones and logistics parks. Most zones are, however, not specialised with specialised zones more prevalent in middle to high income economies; and,

SEZs are different to privately developed industrial estates, which are distinguished by the lack of public sector involvement at any stage of their development or operation.

Figure 13 SEZ typologies



Source: Vivid Economics

As a country develops, so does the type of zone it typically requires. Table 8 shows common zone objectives and types for countries at different stages of income per capita, and sectoral composition. For most low-income countries, zones are designed to attract industrial activity through offsetting a poor investment climate. However, as countries develop, their objectives increasingly focus on upgrading activity towards higher value-add sectors, resulting in a greater prevalence of Specialised EPZs. This transition is apparent within countries, such as Korea or Singapore, whose zones have evolved from export-oriented manufacturing to knowledge and innovation hubs (United Nations Conference on Trade and Development, 2019b).

Table 8 Evolution of SEZs

	Common SEZ policy objectives	Common SEZ typologies
Low-income economies	• Employment and income generation • Attract industrial activities • Improve trade balance • Pilot business reforms in a limited area	• Hybrid Zones • Resource-based zones aimed at attracting processing industries
Middle-income economies	• Diversify export industries • Shift economy to higher value-add goods and services • Technology and knowledge spill overs	• Technology-based Specialised Zones (e.g. R&D, high-tech manufacturing, biotech) • Service-focused zones (e.g. financial services, business process outsourcing) • Specialized Zones and EPZs focused on GVC-intense industries (e.g. automotive, electronics)
High-income economies	• Provide an efficient platform for complex cross-border supply chains • Focus on avoiding distortions in the economy	• Logistics hubs Free Zones only (not industrial Free Zones) • Enterprise Zones • Innovation and new industrial revolution objectives pursued through science parks without separate regulatory framework, or though incentives not linked to zones

Source: Vivid Economics

3.3 Experience of SEZs in Africa

African SEZs emerged as a policy tool in the 1970s and have now been adopted by 38 countries in the region. SEZs were adopted relatively late in Africa, emerging in the early 1970s. Mauritius, Liberia and Senegal were amongst the first African countries to adopt SEZs as a policy tool. Since then, they have become common across the continent. In 2018, there were approximately 237 established SEZs spread across 38 countries in the region (some of these still under construction). An additional 200 single factory EPZs exist in countries such as Kenya.

Zones have contributed to national FDI and exports. A comparison between African and Asian SEZs shows that the contribution of African zones is broadly in line with SEZs in other regions. For example, Ghana's Tema SEZ accounted for 33% of non-oil exports in 2008, equivalent to Vietnamese SEZs (Farole, 2011). In absolute terms however the scale of investment and job creation remains far lower than South Asian or East Asian counterparts. This could be partially explained by the relatively early stage in development of these zones, smaller population size and the economic activity of the host countries.

Activity has leveraged the abundance in natural endowments, particularly in agriculture, oil and minerals. The presence of natural resource endowments and policy efforts to move away from the export of unprocessed resources has driven the desire of many African governments to set up agro-zones and oil refinery zones that support local value-addition. Industries in African SEZs have typically exhibited a larger share of SEZs focused on the downstream processing of agriculture and minerals (Farole, 2011). Examples include Lagos Free Trade Zone in Nigeria, cocoa processing zones in Ghana and the Dube Agri zone in South Africa, detailed in Box 3.

Box 3 CASE STUDY: Dube's agro-processing cluster highlights the importance of shared infrastructure and business support services

Since its launch in 2012, Dube Agrizone has developed into a successful agro-processing cluster. The Dube Agrizone is located within the Dube TradePort SEZ in KwaZulu-Natal, South Africa. The zone's developer, Dube TradePort Corporation, launched the zone with the specific objective of producing high-value fresh produce for both domestic and export markets. Through achieving this objective, it also contributes to the Dube TradePort's overarching aims: developing South Africa's manufacturing and export capabilities and attracting FDI in alignment with the country's National Development Strategy.

Firms within Dube Agrizone benefit from shared infrastructure tailored to the needs of the agricultural sector. The zone's success is partially driven through its provision of hard and soft infrastructure, which together create a highly integrated system for the production, processing and exportation of short shelf-life food produce. Incentives include 160,000 m^2 of climate-controlled greenhouses, post-harvest packhouses, a distribution centre and research facility (known as the Agrilab). Through the provision of shared infrastructure, the zone helps to cluster agri-processing businesses. This sectoral clustering is noted to achieve positive impacts in terms of reducing business transaction costs.

Non-sector specific business support services at the same time help to improve the overall investment climate. Businesses in the Agrizone eligible for a range of additional incentives, provided including:

- fiscal incentives, such as a preferential 15% corporate tax for qualifying entities and building allowances of up to 10% per annum;
- financial incentives, including as an SEZ fund;
- hard infrastructure, such as data-centres, a trucking fleet, and telecommunication services; and,
- soft infrastructure, such as a one-stop shop to streamline regulatory processes; cross-business mentorship and training programmes; enterprise development initiatives; and, entrepreneur and employee training schemes.

Efforts to attract sectors such as warehousing, logistics and storage, also acknowledge the value-add achieved through clustering of the entire supply chain for investors. Recognising the important benefits of agglomeration in helping increase efficiency and reduce costs, Dube TradePort corporation have sought to attract several 'supplementary' sectors to supply to priority economic activities across the zones. The 'supplementary' sectors include freight, warehousing, cold storage, logistics and renewable energy.

Sources:

https://www.dubetradeport.co.za/SiteFiles/152060/Dube%20TradePort%20Special%20Economic%20Zone%20-%20Investment%20Brochure%202018.pdf
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https://www.bizcommunity.com/Article/196/358/157483.html
http://www.ruraldevelopment.gov.za/agri-parks#.Xal8LuhKjIU
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https://www.iol.co.za/business-report/companies/company-operating-in-the-dube-agrizone-to-harvest-first-crops-31724446
https://www.brandsouthafrica.com/south-africa-fast-facts/news-facts/08-oct-14-6510

However, the impact of African SEZs on industrial upgrading remains unclear. Zones in Africa have not typically been successful in helping to shift economies towards manufacturing sectors, even when generating short-term benefits. Analysis of the sectoral split of exports in one study of African zones shows a limited change in industrial activities despite the presence of new zones (Farole, 2011). Mauritius is one exception, which has witnessed a transition from an agriculture focused economy to one dominated by financial services since the deployment of SEZs as a policy tool.

The inability to create long-lasting impact through SEZs can be explained by the lack of one or more criteria for zone success. Zones in Africa have been disadvantaged by a lack of:

- **institutional coordination**, with different incentives offered across the economy often undermining the business case of an SEZ, as exhibited in Nigeria, where there was disagreement over the duty exemption offered by Ministry of Finance and delivered by Nigeria's customs agency.
- **regulatory certainty**, with constant changes in SEZ laws resulting in an unpredictable investment climate that is difficult to navigate. This has been witnessed in Senegal, which has frequently changed policy over multiple issues, including eligibility requirements and corporate tax exemptions.
- **implementation capacity**, even in cases where institutions are set up, the lack of financial or technical capacity of SEZ agencies, such as zone one-stop-shops and investment promotion agencies, can lead to a poorer service provision and low levels of investment;
- **high-quality physical infrastructure**, with average electricity downtime in a sample of African SEZs at 44 hours per month, zones are often unable to offer the supply of low, cost and reliable utilities and transport that investors cite; and,
- **attractive incentive offering for international investors**, with African zones failing to compete internationally, despite the advantages they offer relative to the national or regional business climate. The relative lack of regional investment flows can enhance the competitive landscape that many African SEZs face (Farole, 2011).

Countries across the continent are renewing efforts to revitalise SEZs as a tool for industrial policy and investment promotion. Several African countries have recently relaunched new or reformulated SEZ strategies. In some countries, such as Botswana and Kenya, policy efforts have been based on careful strategic planning of where SEZs can support national development goals. Botswana's Specialised SEZs, for example, aim to focus efforts towards national priority sectors, such as health and education. Learning from past failures regarding institutional coordination, a consensus-based strategy has increasingly been deployed. Development of Kenya's SEZ programme was based on collaboration between Ministry of Trade, Ministry of Industry and the Prime Minister's Office. The implementation of best practice in a new generation of zone programmes in Africa signals an increased likelihood that zones will deliver greater benefits to host economies.

As a latecomer to the SEZ space, Lesotho can learn from the successes and failures of other zones in the region and adopt best-practices, outlined in the following sections.

4 SEZ strategy and vision

4.1 Global SEZ best practice

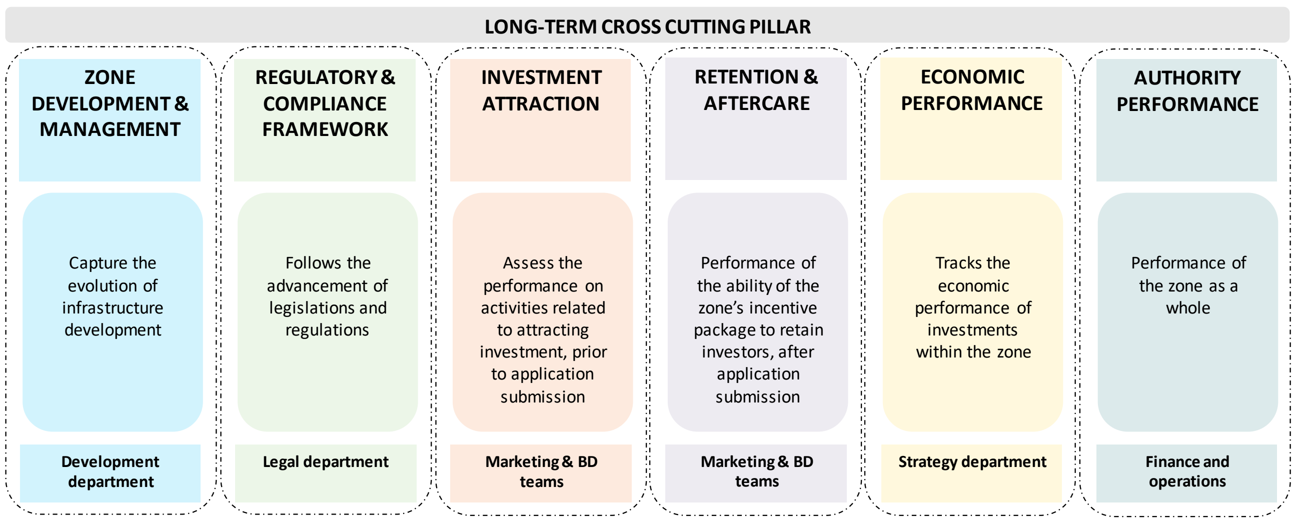
Global experience with SEZs shows that the development of a successful SEZ regime requires a clear vision and a long-term government commitment. SEZs are not a quick route to development, often taking many years before they provide significant positive benefits for the host economy. To ensure that parks are able to deliver on their full economic potential requires a clear vision of the value-add SEZs provide to the economy and a commitment by high levels of government to the long-term path to developing successful SEZs.

A SEZ policy is an essential foundation to any future regime, helping to identify and clarify the objectives of zones and set out the practical steps to managing effective SEZs. An SEZ policy clarifies the objectives of future SEZs, highlighting the value proposition a country's zones offer to international investors. Besides serving as an investment promotion tool, the policy also helps improve coordination between government actors and with potential private sector investors. The policy ought to set out the governance of SEZs, the role of government and the procedures to develop a new SEZ, among other factors. This institutional and regulatory framework, later enshrined by SEZ law, helps to increase the efficiency of developing and managing SEZs and the scrutiny over public sector investments.

The objectives of SEZs should be clear. Zones with a core economic or social policy objective enable a clear development strategy, including the design of an incentive package tailored to meet the needs of investments which contribute to these objectives. In contrast, zones that lack focus in their objectives are likely to result in a range of incentives, unattractive to all groups of investors. Successful zones prioritise two to three core objectives that the zone works towards.

Given the long-term nature of SEZs regular monitoring and evaluation of their performance via a standard set of performance indicators is essential for effective policy management. Key performance indicators (KPIs) should be set for both the performance of individual zones as investment attraction tools and the effectiveness of government agencies regulating and supporting the development and operation of zones. Figure 14 sets out indicative categories that are covered in best practice KPI frameworks. Just as SEZ policy objectives are specific to the national regime, KPIs should reflect what SEZs are expected to contribute in their base economy.

Figure 14 Indicative pillars for an SEZs KPI framework



Source: Vivid Economics

An SEZ policy is not a panacea and should not replace wider investment climate reforms. History reveals countless examples of zones that have failed to meet expectations, or even attract investment. Their failure is partly explained by challenges in the wider economy, including access to high-quality labour and low-cost utilities, that contributed to a poor value proposition in the zone. A well designed SEZ regime can help to offset some of these challenges; but is insufficient to guarantee the transition of an entire economy onto a higher value and sustainable growth trajectory. Even when these market challenges do not inhibit the success of the zone, they imply an SEZ will operate as an enclave with few linkages to the wider economy. Whilst an SEZ regime can set out ambitious objectives, it remains reliant on improvements in the wider investment climate to maximise its impact.

Integration of SEZ planning into a long-term national strategy is a critical driver of success. The impact of SEZ investment have typically been limited in countries where zone activities were not coordinated with national initiatives. To ensure an SEZ regime supports national development plans, rather than duplicates or undermines them, should involve:

- recognition of the value-add that SEZs provide for the national economy, for instance in creating industrial clusters or attracting FDI for regional job creation. An SEZ should be viewed as a delivery tool for achieving the ambitions of a country's industrial policy;
- coordination across government and private sector to align an SEZ regime's sectoral focus, sequencing and geographical location with national policies surrounding industrialisation, investment promotion and spatial planning. South Africa's and Kenya's recent SEZ programmes have built upon widespread consultations at high levels of government, for instance;
- pragmatism over what an SEZ regime can achieve in the short-term, based on national and regional comparative advantages; to ensure zones target investors successfully and limit their cost outlay requires an SEZ policy that acknowledges current strengths and sources of competitiveness; and,
- a staged approach to SEZ development, which seeks to build competitiveness in higher value-add industries over the long-term, can ensure that SEZs are a tool for upgrading economic activity; and,
- flexibility of the SEZ vision towards a country's evolving national competitiveness can help reduce cost outlays for zone developers, helping them take advantage of industries where investor interest is already high. In practice, the adaptiveness of the SEZ vision increases to the extent that it is not specialised or if, at regular intervals, reviews objectives and specialisation focus.

A phased approach to developing zones can benefit a country's progress towards achieving their SEZ vision. A long-term strategy for a zone will often involve multiple phases, with larger projects divided in up to phases over a 30 to 40-year timeline (PwC, 2018). This is partly due to practical challenges, such as the time it takes to secure tenants. It is also preferred due to the benefits that phasing provides, including:

- an increased competitiveness of firms within the zone: phasing zone activity typically facilitates greater clustering of firms at the site level. This can facilitate an increase in knowledge spillovers and reduced development costs through shared infrastructure;
- improved cash flow management for zone developers: the need to balance capital costs of developing a zone with revenue from sales is often benefitted by a phased approach, which helps to bring in incremental cash flows for the next phase of zone development; and,
- an increased attractiveness to future investors: the success of an initial cluster, with as few as five to ten companies, demonstrates the value of the zone to future investors. Developers can reduce their risks by piloting zone development in the initial phase, before following investor demand.

The benefits of phasing imply an SEZ policy should prioritise the development of fewer, highly occupied SEZs, and build on areas of success and gaps identified by regular monitoring and evaluation through an established KPI framework.

Box 4 CASE STUDY: Kigali SEZ has increased the productivity of local firms, in the absence of local supply chains

Since its establishment in 2013, Kigali SEZ (KSEZ) has helped to increase net exports and diversify Rwanda's export base. Rwanda's SEZ programme benefits from high levels of government commitment. The regime was launched in alignment with President Kagame's Vision 2020 plan, which created the Special Economic Zones Authority of Rwanda (SEZAR) to regulate and implement zones within the Rwanda Development Board (RDB). The objectives of SEZs therefore explicitly aligns with wider national targets, such as to stimulate export growth and diversification, develop industry and non-agricultural sectors and raise GDP per capita levels to Vision 2020's target. Already, KSEZ has been contributed to achieving programme objectives, with export to the zone between 4 and 10.5% of the national average from 2013 to 2016.

Achievements of the zone are notable because they have occurred despite the absence of tax incentives and local supply chains. The success of KSEZ is interesting because it occurs despite the lack of other features typical for SEZs. Firms in the KSEZ are not eligible for tax incentives and operate in the absence of local supply chains.

Access to imports has been a key driver of the zone's success, enabling competitiveness of firms despite local inputs. Firms in the zone benefit from low tariffs on imports, owing to the 2017 'Made in Rwanda' policy. This has allowed KSEZ firms to become large importers and boost their productivity despite lack of local input availability.

Expertise and lobbying services provided by the RDB also help to make KSEZ a highly attractive investment location. Firms in KSEZ benefit from the provision of reliable utilities, high quality transport infrastructure and expedited regulatory processes. For example, firms are granted accelerated customs procedures and streamlined access to the Rwandan Duty Remission Scheme. The close relationship of the RDB to higher levels of government also allow it to provide tailored support to businesses that exceed international best practice. For instance, RDB are known to lobby in favour of KSEZ firms regarding specific challenges they face and provides firms with updated information on new laws and regulation.

Sources:

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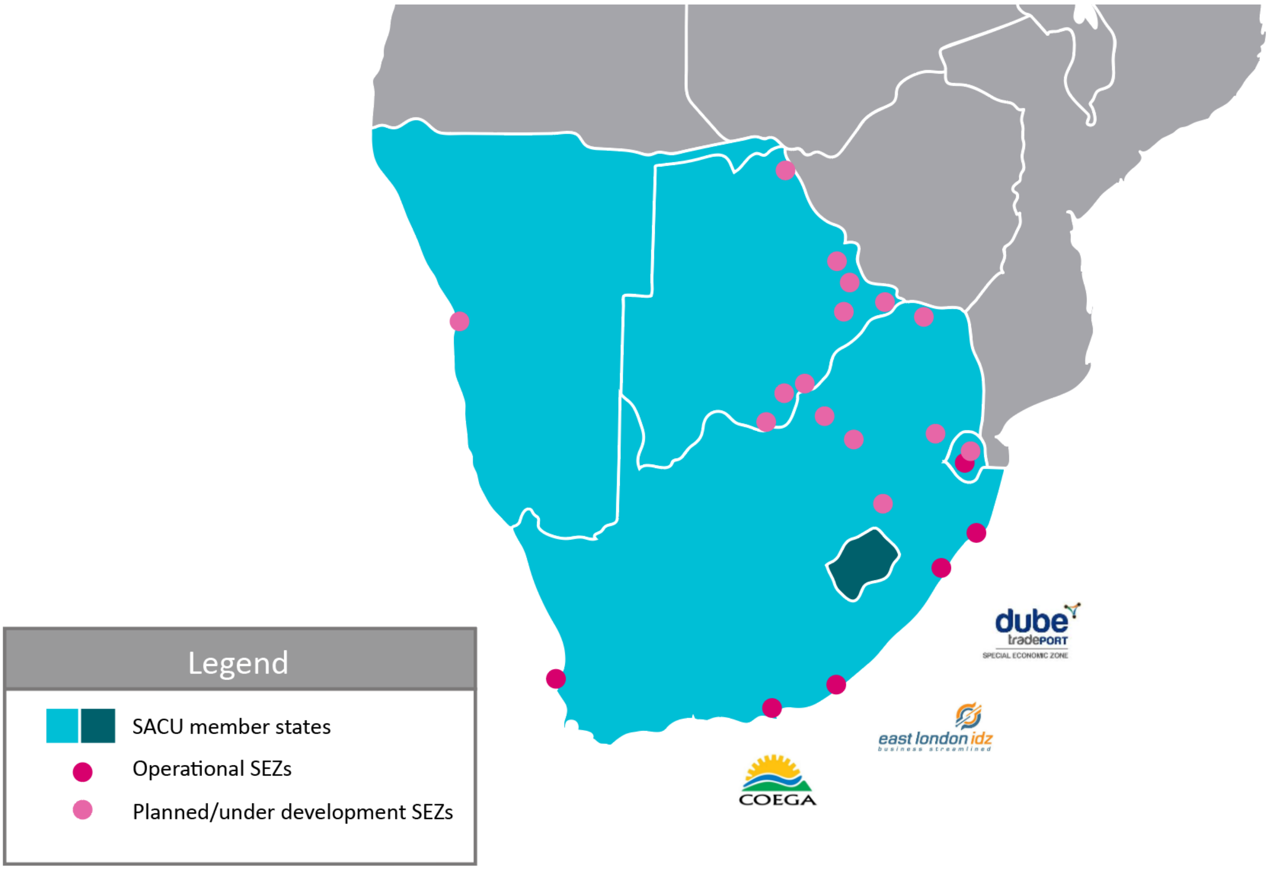
https://www.theigc.org/project/analysing-impact-kigali-special-economic-zone-firm-behaviour/
http://www.minicom.gov.rw/fileadmin/minicom_publications/policies/SEZ_Policy_Cleaned_.pdf
https://www.bcci.bg/resources/files/Invest_in_Rwanda__Projects_May_2017-new.pdf
https://www.ecoi.net/en/document/1279313.html
https://www.ft.com/content/4fd23ff8-ded6-11e4-b9ec-00144feab7de

Zones do not exist in a vacuum but rather in the real world of competition with other zones and zone-type arrangements. In recent years, many SACU member states have implemented enhanced SEZ programmes, as shown in Figure 14. Most notably, this has included a significant expansion of South Africa's IDZ to SEZ programme, from three zones to ten. In 2018, Botswana has also recently announced a programme of eight SEZs across the country. These are currently in various stages of planning and development, given the programme builds on a previous policy.[12] In early 2019, Namibia confirmed plans to upgrade its existing EPZ

[12] https://www.gobotswana.com/fr/special-economic-zones

to an SEZ sited at Walvis Bay on the Atlantic coast. These are in addition to the two zones (one in operation, one planned) in Eswatini. It is of note that South Africa's and Botswana's SEZ programmes are particularly competitive by Sub-Saharan African standards.

Figure 15 Special Economic Zones in the SACU states



Source: Vivid Economics

Box 5 CASE STUDY: South Africa – from IDZs to SEZs

South Africa has had an Industrial Development Zones (IDZ) programme since the year 2000 aimed at repositioning the country in the world economy, attracting Foreign Direct Investment and exporting value-added commodities. Although the IDZs saw major achievements, there were also challenges that led to the policy's review and to the adoption of a new SEZ policy. Some of the key IDZ programme constraints included: (i) lack of coordinated planning arrangements, (ii) insufficient guidance related to governance arrangements, (iii) dependence on government funding, (iv) lack of targeted investment promotion measures, (v) insufficient marketing and (vi) inadequate coordination across government agencies. The policy review and the new SEZ programme, which was launched in 2007, provided a clearer framework for the development, operations and management of the country's zones. South Africa's SEZs are geographically designated areas set aside for economic activity supported by special legal arrangements and systems different from those that apply in the rest of the country. The SEZs may be sector-specific or multi-product in orientation as per the *SEZ Act No. 16 of 2014*. Recognising longer term funding constraints, the SEZ Act and the SEZ strategy moreover encouraged the private sector to play an active role in the South African Special Economic Zones Programme. The SEZ Act envisages public private partnerships in the development and operation of Special Economic Zones via: assembly of land parcels with secure title and development rights by the government for subsequent lease to private zone development groups; a Build-Operate-Transfer PPP approach to zone infrastructure and facilities; government guarantees and financial support; contracting private management for government owned zones; and leasing of government-owned SEZ assets by private operators.

Sources: World Bank; Locus Economica; dti (http://www.thedti.gov.za/industrial_development/sez.jsp and http://www.thedti.gov.za/DownloadFileAction?id=830)

Beyond activities within SACU, there has also been a significant growth in SEZs across Southern Africa. In addition, Mozambique and Madagascar have established SEZ programmes over the past decade. Zambia has a new SEZ in Lusaka (the 'multi-facility economic zone' or 'MFEZ'). Angola has recently launched sales of plots within the Luanda-Bengo SEZ ('ZEELB'). Zimbabwe has a ('single factory' type) SEZ programme. Finally, Malawi is currently studying the possibility of establishing one under an ongoing World Bank programme.

4.2 Lesotho's gaps relative to best practice

Lesotho does not have an SEZ or similar policy which clearly sets out the objectives and responsibilities for the provision of industrial infrastructure and the offer to investors. Many international organisations, including the World Bank and UNCTAD, consider the provision of subsidised rent and hard infrastructure in Lesotho's industrial estates akin to an SEZ (United Nations Conference on Trade and Development, 2019b; Zeng, 2015). Since the expiration of the National Industrial Policy in 2013, is no policy framework governing these industrial estates, though the process to set out a new industrial policy has been started by MTI. The objectives of SEZs in Lesotho (including industrial estates), their alignment with national economic strategy and the role of government in their development and operation – including the commitment of resources for their development and operation – remains ambiguous, creating uncertainty for the private sector.

Rental subsidies available at current Industrial Estates favour low value, high employment activities. Rental subsidies disproportionately benefit investments that involve low levels of capital investment and require large amounts of space. This tends to favour business models that are labour intensive with a large number of workers. There creates a gap in Lesotho's offer tailored towards higher-quality investment, with greater capital expenditure, and higher paid, more productive employees. An SEZ regime can address this gap, and in the process differentiate itself from the current Industrial Estate offer.

Alongside industrial estates, there is investor interest for a new, more ambitious and more private sector oriented SEZ regime emerging in Lesotho. LNDC is in the process of exploring proposals for new SEZs in Mafeteng and Berea with interested investors. Both sites differ from existing industrial estates in terms of both sectoral focus and level of private sector involvement in zone development. Field research highlights medical cannabis, pharmaceutical manufacturing, and agro-processing as potential sectors in Mafeteng while existing estates are non-specialised and, in practice, dominated by the textile industry. A joint venture between private developers and LNDC is also being considered, in contrast to the fully public model of development used in industrial estates.

However, there is not yet a shared vision across the government to guide planning for new zones, including potential sites in Mafeteng and Berea. New sites imply different zone objectives, regulatory processes and incentive offerings. LNDC recognises the value that could be achieved through more concerted efforts to create and promote an SEZ regime in its 2018-2023 strategic plan. The key objectives for an SEZ regime include improving the national trade balance, attracting higher quality FDI (which supports value chain and skills upgrading) and support for the development of priority sectors. There is also a desire to increase private sector involvement in the development of new zones.

5 SEZ incentive offering

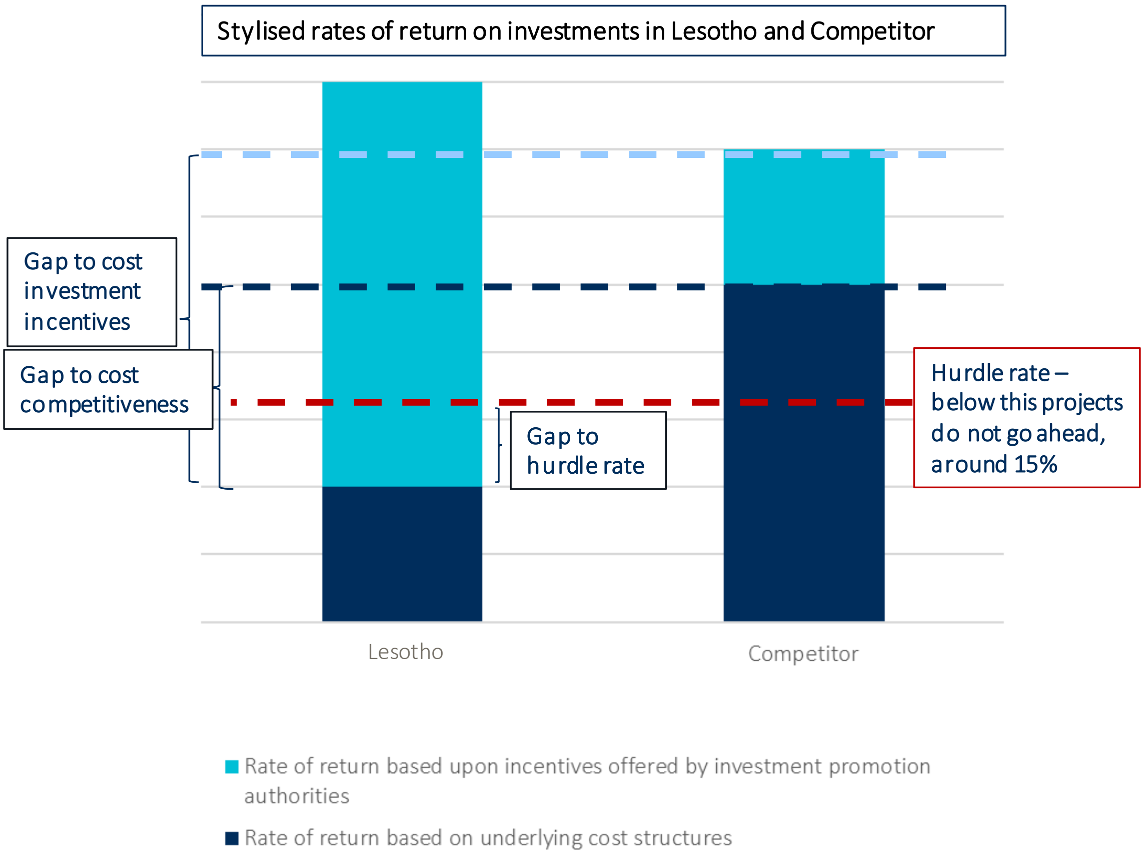
5.1 Global SEZ best practice

SEZs rely on specific incentives which encourage investment and economic activity within the zone. Incentives offered by SEZs are essential to attracting investment additional to what would otherwise occur in the national economy. Without the well-performing "software" of zones' investment climate and policy regime, their physical "hardware" alone makes them little more than a real estate proposition, with no "special" attributes and no comparative advantage relative to other good industrial zone locations within the country or broader region, let alone SEZs. The special draw of SEZs is often to be found in their policy-based "software" element. Furthermore, zones regimes are deemed "free" in large part because of their duty-free customs regimes –a key feature in most zones programme today as in the past. However, a SEZ customs regime requires special adaptations as compared with a national one – special adaptations which a Government sponsor may or may not have considered. Incentives can be classified under four key categories:

- **fiscal incentives** which reduce tax expenditures, including exemptions from tax base, allowances and credits, rate relief, tax deferrals, duty exemptions on imports and exports and VAT exemptions and accelerated depreciation (COMCEC, 2017; United Nations Conference on Trade and Development, 2003);
- **financial incentives** which provide direct finance to companies in the form of grants and subsidies for inputs or outputs, loan guarantees or loans at concessional interest rates (United Nations Conference on Trade and Development, 2003);
- **hard infrastructure incentives** which provide physical infrastructure to support the production of goods and services including provision of roads, railways and port infrastructure, real estate, designation of strategic locations and land ownership (COMCEC, 2017); and,
- **soft infrastructure incentives** which strengthen the enabling environment and improve the ease of doing business, either by changing the underlying legal structure or providing services to reduce administrative delays including simplified export-import procedures, change in labour standards, foreign ownership allowance (COMCEC, 2017).

In order to be effective drivers of foreign investment attraction, incentives should be considered from the firm perspective, in terms of how the impact specific returns to investment. As shown in Figure 16, a typical foreign investor will have multiple incentive offers to consider, across multiple locations. For a given SEZ to attract investments from outside of its host country (and implicitly away from alternative investment locations), the combined incentives available to an investor must exceed a minimum 'hurdle rate' of return (e.g. at least higher than the commercial lending rate that firms realise a return from investing as financial capital). Additional considerations will include competing investment locations (e.g. other SEZs) that target investors may be considering.

Figure 16 Investment incentives must be proportional to size of investment and competitor offers



Source: Vivid Economics

As most SEZ tenants will have significant up-front capital investments (e.g. buildings and facilities), the value of fiscal and financial incentives offered in a given SEZ should be considered against these capital expenditures. International reviews have found incentive packages worth up to 25% of CAPEX to be common (Vivid Economics, 2019).

Incentives designed to support initial investment typically aim to reduce the cost of capital faced by investors. These can take the form of direct subsidies (grants), concessional loans or equity investments, or credit guarantees. Grants and equity are generally more appropriate during project preparation, whereas concessional loans and credit guarantees are appropriate at financial close. Each of these instruments transfers some of the risks of the project to the public sector. Credit guarantee schemes are often preferred by governments because they create higher investment multipliers (reserves can be used to guarantee multiple projects, assuming the risks are not correlated).

Incentives are most effective when they are aligned with the needs of potential investors, which typically include access to low-cost utilities, transport infrastructure and a low administrative burden. Table 3 summarizes the relative importance of different types of zone characteristics based on detailed investor surveys undertaken during SEZ demand studies (Farole, 2011). Firms in African zones cite access to utilities, transport infrastructure and the business regulatory environment as the top three factors that influence their decision to invest in a site. A combination of different types of incentives (fiscal, financial, hard and soft infrastructure) will be required to meet a typical investor's needs, as set out in Table 3.The exact incentive offering of an SEZ ought to consider the specific requirements of a zone's investors, which can be informed by their sector of economic activity and by individual consultations with potential investors.

Table 9 Criteria for selecting an investment location according to surveyed SEZ firms (rankings by region, top five criteria highlighted)

Investment criteria	Type of incentive which can apply	African zones (rank)	Non-African zones (rank)
Cost and quality of utilities	**Hard infrastructure** **Financial incentives** e.g. subsidised utilities **Soft infrastructure** e.g. regulation allowing for distributed electricity generation	1	3
Access to transport infrastructure	**Hard infrastructure** e.g. provision of rail, road and maritime infrastructure	2	2
Business regulatory environment	**Soft infrastructure** e.g. one stop shops for reducing the regulatory burden for businesses	3	5
Tariffs, duties, and rules of origin	**Fiscal incentives** e.g. import duty exemption **Soft infrastructure** e.g. preferential trade agreements and expedited customs processes	4	8
Level of corporate taxes	**Fiscal incentives** e.g. tax holidays	5	6
Access to highly skilled labour	**Soft infrastructure** e.g. access to visas **Financial incentives** e.g. labour training schemes	6	4
Access to suppliers	**Soft infrastructure** e.g. allowing national and regional movement of goods via regulatory and trade regime **Hard infrastructure** e.g. transport infrastructure	7	7
Access to low-cost labour	**Fiscal incentives** e.g. exemptions from labour related taxes	8	1
Availability/cost of land and buildings	**Hard infrastructure**	9	10
Access to local and regional markets	**Soft infrastructure** e.g. allowing movement of goods via regulatory and trade regime	10	9
Access to technology	**Fiscal incentives** e.g. import exemptions for technology kit **Financial incentives** e.g. R&D grants	11	11

Source: Vivid Economics based on Farole (2011)

Site selection also ought to be informed by the needs of potential investors, matching these with the benefits a site provides relative to the wider economy. Just as national incentives are driven by investor preferences, so are local, leveraging site characteristics. Mapping the characteristics of an SEZ offering onto investment sector requirements and drivers can show the relative strengths and weakness of a given SEZ site. For example, an SEZ with good availability of low skilled workers, low cost and reliable utilities, good market access via ports but not rail or air will be suitable for well-preserved agro-processing products that are not time sensitive (e.g. jams and jellies) compared to textiles and apparel inputs to 'fast-fashion' supply chains which are more sensitive to turnaround and delivery timelines. Conversely, investors in sectors such as automotive components and pharmaceuticals would require high skilled workers and quicker market access for inputs and end-products.

To create 'additional' investment, incentives ought to tackle challenges faced by economic actors in the wider economy. Incentives provided in an SEZ are a substantive cost to government. To make sure that government's do not spend money to simply displace economic activity that would have occurred in the zone, or the wider economy, each incentive should be targeted to overcoming a challenge that deters investors today. Where a host economy already offers businesses low-cost utilities, relative to its peers, subsidies for firms operating in SEZs will drain government revenue without attracting additional investment, for example. Contextual factors also highlight which incentive is most likely to have a positive impact on the levels of investment. In economies where cost of utilities is a challenge due to an inefficient monopoly utility supplier, regulation allowing third-party generation of distributed energy can ensure low-cost power is delivered at a lower cost to government.

To the extent that businesses in low- and middle-income countries face a difficult business environment, incentives which improve ease of doing business in zones are particularly important in attracting investment. Many low- and middle-income countries typically suffer from a poor business environment, typically measured as the difficulties faced in obtaining licenses to start a business; delays in accessing necessary inputs for commercial success, such as capital, labour and finance; and, high day to day administrative costs, whilst paying taxes and enforcing contracts (The World Bank, 2019). For an investor in Uganda, setting up a business can require 13 separate processes that take up to one month, for example. Soft and hard infrastructure incentives are particularly important to alleviate the challenges the operational challenges businesses face. Specific incentives include:

- a one-stop-shop to streamline business administration;
- accelerated customs inspections procedures; and,
- automatic approval of foreign work visas.

Financial incentives can be targeted to support initial investments (CAPEX) or ongoing costs (OPEX). Financial incentives offered across successful SEZ regimes vary widely, ranging from technology specific subsidies to innovation funds. Overall these financial incentives seek to attract investors either

- through reducing upfront costs of investment, through access to low-cost finance); or
- lowering operational costs and thereby improving competitiveness (via subsidies for the costs of inputs and upgrading the factors of production, such as labour training).

When designing tax-specific incentives for SEZs, best practices as set out by the OECD can be of use. These are summarised in Box 6.

Non-fiscal incentives are also vital to help an SEZ provide a unique value add for investors, helping zones to compete for highly mobile flows of international investment. Most SEZs across the world offer relatively similar fiscal incentives, including corporate tax holidays and import duty exemptions. These incentives imply a zone is attractive relative to the wider host economy, but do not help to differentiate between sites within a region. Fiscal incentives alone are, therefore, not a decisive factor for investment in a country's SEZs (United Nations Conference on Trade and Development, 2019b). To attract international investors, countries must consider creating an investment climate that is attractive relative to other comparable zones, either in the region or with a similar sectoral focus. The exact package of zones will depend on matching the natural comparative advantage a country offers.

Box 6 SEZ Fiscal Incentive compliance with global 'Base Erosion and Profit Shifting' ('BEPS') rules

OECD Tax Haven Rules include the OECD Agreement on the Exchange of Information on Tax Matters; 2017 Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ('BEPS Treaty'); OECD 2017 Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations; and OECD Controlled Foreign Company (CFC) Rules.

These rules have nothing to do with tax rates and legitimate fiscal competition but essentially impose:

- Transparency commitments (e.g., absence of 'banking secrecy' legislation, exchange of tax information and prosecution cooperation); and
- Respect of the Financial Action Task Force (FATF)'s anti-money-laundering (AML) and anti-terrorism-financing (ATF) standards.

The EU "Code of Conduct" (Council of the European Union Resolution on a Code of Conduct for Business Taxation of 1 December 1997) contains similar tax transparency and anti–BEPS measures. The EU (guidance regarding which can be found here: https://www.consilium.europa.eu/register/en/content/out?DOC_TITLE=code+of+conduct+guidance&DOC_SUBJECT=FISC&i=COCGGD&ROWSPP=25&DOC_LANCD=EN&ORDERBY=DOC_DATE+DESC&typ=SET&NRROWS=500&RESULTSET=1&TARGET_YEAR=2018). However, it also has a new "fair taxation" criterion ("Criterion 2.2"). In 2017, third-party jurisdictions with low or zero rates of corporation tax were first the first time assessed against Criterion 2.2, which states that these "jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction".

The EU Code of Conduct, like the OECD BEPS rules, does not prohibit either low or even 0% corporate income tax rates to be applied by concerned jurisdictions; it only results in problems for them if the jurisdiction is specifically targeting "offshore" (e.g., non-manufacturing, non-logistics, largely financial, non-resident, un-audited) activity, in a manner that is deemed non-cooperative with the EU. Indeed, the Code guidance explicitly states that "absence of a corporate tax base or a zero or almost zero level tax rate cannot by itself be deemed as criterion for evaluating a jurisdiction as non-compliant" (See: Agreed guidance by the Code of Conduct Group (business taxation): 1998- 2018, 5814/3/18 REV 3, FISC 44, ECOFIN 75, 13 July 2018, p. 116).

Source: Locus Economica

5.2 Lesotho's gaps relative to best practice

The core incentive offering of Lesotho's Industrial Parks is the provision of land and subsidised rental rates. Table 4 set outs the incentives available to firms operating in Lesotho today, relative to those common across successful SEZ regimes. A review of Lesotho's investment incentives highlights the majority of these are not 'special' to geographic areas and lack the spatial focus common for SEZ regimes.

The current subsidies to rent for tenants of LNDC's industrial parks represent a significant financial incentive for investors. Indicative calculations suggest that this could represent between 5% and 20% of the value of CAPEX for a typical textile investor. The scale of these financial incentives represents an internationally competitive offer but, as discussed above are unsustainable. They create an unlevel playing field between private industrial estate developers and LNDC Industrial Estates. This will create a challenge for attracting private SEZ developers.

LNDC has highlighted the need for a review of current investment incentives offered in Lesotho in its latest strategic plan (Lesotho National Development Corporation, 2018). This acknowledgement recognises the changing nature of both the global competitive environment for investment and a realignment of priority sectors for investment attraction in Lesotho. The introduction of SEZs alongside existing industrial estates will provide an opportunity to review and develop this incentive offer to investors.

Table 10 Lesotho's current incentive offering

Type of incentive	Industrial Parks incentive offering	National incentive offering
Fiscal	• There are no fiscal incentives which are specific to Lesotho's Industrial Parks	• national incentives for agriculture and manufacturing • 10% tax on profits for intra-SACU trade • 0% withholding tax on dividends to shareholders in manufacturing sector • 10% withholding tax on payments for external management skills and royalties
Financial	• subsidies on factory shell rents	• Project Preparation Facility, which can help to fund feasibility studies and project-structuring activities • Partial credit guarantee scheme provided by LNDC
Hard infrastructure	• provision of land	•
Soft infrastructure	• public maintenance of common areas in its estates by LNDC e.g. security, waste management, provision of off-grid electricity generation	• foreign work visas are available to investors for up to three years, after which they can be renewed • One Stop Business Facilitation Centre (OBFC), which provides online company registration and in-person services for manufacturing licensing, resident permitting, and tax registration (excluding PAYE)

Source: Vivid Economics

Headline corporate tax rates in Lesotho are low compared to regional competitors within SACU. Lesotho offers both manufacturing and agricultural sector incentives at the national level (see Table 4). The standard rate of corporate tax in Lesotho is 25%. However, this is reduced to 10% for manufacturing sector profits. Incentives are not geographically specific or targeted towards activity across the current industrial estates. A previous incentive, which reduced corporate tax rates to 0% for exports outside of SACU, was ended in 2014. There is, furthermore, no withholding tax on manufacturing dividends to shareholders, and just a competitive 10% withholding tax on payments for external management skills and royalties.

However, many other countries offer significant enhanced tax allowances and accelerated depreciation which reduce effective tax rates. For example, in Mauritius, the headline corporate tax rate is 15%, but the effective rate is 0%. Several EPZs across Namibia, Kenya, Mozambique, Ethiopia offer tax holidays (also available in Botswana through the development approval order). Internationally, zero-rate corporate taxes are commonly available in economic zones. VAT in Lesotho is levied at 15%, in line with all other SACU countries apart from Botswana (12%).

Fiscal and financial incentives are commonplace amongst SEZ investors and countries throughout the region, and any SEZ regime proposed in Lesotho will need to be fully compliant and competitive with SACU requirements and norms. Given the preponderance of existing SEZ regimes with SACU territories, these may offer the country a sound basis for moving forward. A selection of neighbouring SACU regimes can be found in Table 11. In Lesotho, only the LNDC Law, regulated by the Ministry of Trade and Industry (MTI), currently provides for serviced industrial park plots. There are no EPZ or analogous regimes on offer in the country at this time. The Tax Code, regulated by the Lesotho Revenue Authority (LRA), however provides incentives to investors choosing to establish themselves in LNDC industrial estate programme, and the Government is committed to offering regionally competitive taxation levels. Furthermore, there appears to be Government willingness to enter into SADC/SACU/TFTA "grey areas" as regards tax incentives for investors, as and where required. Indeed, Parliament has (and uses) authority to declare industries “infant industries” under SACU agreement, allowing additional duties to be applied for their protection for eight years at a time.[13] The Customs & Excise Act 1982 also offers a duty-drawback scheme for exporters, and provides for customs warehouses and bonded warehouses, special customs and excise special manufacturing warehouses for wine, and general customs and excise special manufacturing (and storage) warehouses. Tariffs on inputs may therefore not necessarily represent a significant cashflow drag on exporters of textiles and foodstuffs to the EU, the US or the SACU markets -especially as free trade agreements are also in place.

Table 11 Comparative SACU SEZ regimes

	South Africa	Botswana	Namibia	Eswatini
Corporation tax	Preferential 15% rate, plus additional reliefs available (i.e. employment taxes)	5 years at 5% rate 15% rate levied after this period	Preferential rate of 18% for first 10 years, plus accelerated depreciation	20 years at 0% rate 5% rate levied after this period
VAT, customs and duty deferment	Rebates on customs duty and VAT incurred for any exports outside SACU	Rebates on customs duty and VAT for any exports outside SACU	Not yet announced	Rebates on customs duty for any exports outside SACU
Customs duty on imports (raw materials)	Various reliefs available	0% rate	Not yet announced	0% rate
Customs duty on machinery and capital goods	Various reliefs available	-	0% rate	-
Land regulations	-	Minimum lease period of 50 years (25 years in the rest of the economy)	Not yet announced	-

Note: This is a high-level comparative assessment and may not be complete
Source: Vivid Economics

Lesotho’s customs legislation and regulations are national in scope and have never differentiated in terms of how they are applied to LNDC industrial estates. While SACU customs procedures and duty-drawback facilities are appreciated, as previously noted, Lesotho has not as yet contemplated “no-duty, no drawback”

[13] See. Southern African Customs Union (SACU) Agreement 2002, Sec. 26. Note that this authority may be subject to EU approval given the EU-SADC EBA Agreement.

arrangements for exporters, nor derogating any aspect of customs management to zone regulators such as LNDC, to ensure a more integrated and facilitative regulatory oversight package for zone investors.

LNDC offers a Partial Credit Guarantee Scheme to private sector developers, which it aims to double by 2022. The agency's strategic plan envisions a staged expansion of 25% over the four years from 2019-2022 (Lesotho National Development Corporation, 2018). The existing scheme provides lender's banks with 50% guarantee coverage for loans up to M 5 million and requires project developers to provide at least 15% collateral. Further requirements include the ability to reach a 60% debt to equity ratio within the first two years of operation. As of 2016, the PCGS supported 33 projects borrowing M 19 million in loans. The scheme was capitalised a M 20 million as of 2016.[14]

Provision of further financial incentives remains limited relative to international standards. The financial incentives offered to investors in Lesotho are to a large degree limited to the rental subsidies available in Industrial Parks. There is no financial support available for labour, utilities or capital inputs. International benchmarking highlights other successful SEZs have typically provided concessional finance, R&D grants and employment training subsidies, among other financial incentives, to attract investors, although historically cash incentives have been provided to textile and apparel manufacturers to maintain employment.

Credit guarantee schemes and project preparation funding can help to lower private sector risks when developing or investing in Lesotho's SEZ regime. These are exacerbated by the large capital outlays required to develop a zone before it is operational and able to achieve returns. The Government of Lesotho can help to reduce these risks either through credit guarantee schemes, which imply the government absorbs a share of any future losses, and funding for the preparatory stages of projects, which can help to reduce upfront costs and uncertainty over project feasibility. A credit guarantee scheme is a particularly attractive option because it has no direct cost outlay for the government and avoids crowding out government investment.

Greater levels of private interest in Lesotho's zones could also be supported through a concessional loan facility, though this is likely to require support from international development banks. Access to low-cost finance has shown to be a successful tool across SEZs globally. However, field research highlights that there is limited financial capacity to support such a scheme through national sources of funding. It ought to therefore be presented to international multi-lateral and bi-lateral development banks as a concept which requires their financial support.

Specialised insurance pools, including for immature markets in Lesotho, can be a key incentive to attract foreign investment. For example, given Lesotho's unique position as the first African country to grant a license for the cultivation of medical cannabis, crop insurance which caters for cannabis growers may fill a market gap. While international insurance providers currently underwrite investments in the cannabis industry (Canadian providers), the international standard for foreign investors is to have 20% of output insured in the local market.[15] Specialty national insurance pools established by legislation and administered by Government can reduce barriers to entry for foreign investors related to risk management.

Lesotho enjoys a measure of global credibility and competitiveness in terms of its general business regulatory environment and policy regime. Notably, for instance, as regards investments' business registration and licensing, Lesotho leads within SACU in business registration, with its online MTI one-stop business facilitation centre (e.g., one-stop shop; declarative business registration and tax filing systems, etc.). Similarly, as regards activities licensing, it is currently in the process of developing a risk-based e-licensing regime with UNCTAD assistance. Relative to such regional neighbours as Madagascar, Mozambique or even Mauritius, Lesotho's simple, Common Law based basic freedom of commerce, "laissez-faire" light regulatory compliance burdens,

[14] https://slideplayer.com/slide/6240308/
[15] Consultant team interview with Berkeley Risk experts 15 October 2019

as well as its colonially inherited declarative systems, stand it in good stead Furthermore, foreign work visas are available to investors for up to three years, renewable.

Businesses in Lesotho's Industrial Parks do not benefit from a distinct regulatory structure and experience little reduction in administrative costs relative to firms operating elsewhere in the country. The existence of an OFBC in Maseru serving all businesses in Lesotho and the low levels of regulatory compliance imply businesses nevertheless face a relatively simple regulatory environment compared to many neighbouring economies. For example, Lesotho leads within SACU in business registration. It is also in the process of developing a risk-based e-licensing regime with UNCTAD assistance. However, many investment challenges continue to persist in the national economy.

Experience shows that SEZs could be utilised more effectively to tackle many of the challenges that continue to hinder investment in Lesotho. Field research highlights that key investment challenges facing Lesotho include:

- access to high quality labour;
- provision of high-quality ready-built infrastructure; and,
- administrative cost of doing business.

These challenges are currently not tackled by the country's Industrial Parks programme, despite being addressed in the context of many SEZ regimes globally.

Access to skilled labour is one of the key challenges highlighted by investors, resulting from a lengthy visa approval processes and a lack of skills training initiatives. Access to local skilled labour is commonly cited as a barrier to Lesotho's diversification to higher value-add sectors. At the same time, labour regulations intended to improve the skills of locals instead simply deter higher quality foreign investment. Approval of foreign work visas is a time-consuming process, for example, with proof required by a company that it was both unable to hire a Basotho worker and are providing a skills training programme for a national (Ministry of Labour Government of Lesotho, 1992).

Costs of doing business remain higher than successful zones, which typically benefit from expedited processes and exemptions from burdensome national regulation. Lesotho continues to perform poorly in many of the factors necessary for industrial development. In the World Bank's Doing Business study, for example, the country rank 157th out of 190 countries in electricity access (in part because of missing data on electricity outages), and 171st out of 190 in getting a construction permit. Whilst SEZs across the world increasingly seek to reduce administrative burdens, Lesotho's Industrial Parks offer little to no improvement on the country's business regulatory environment. Neither the LNDC nor OBFC currently have the authority to expedite regulation that is otherwise under the responsibility of other government ministries, for instance.

Access to quality and consistent utilities and hard infrastructure for industrial sites is an important piece of the incentive offer. While Lesotho has significant experience of delivering on-site and servicing infrastructure to the country's industrial estates, a national SEZ programme will require high levels of service and consistency. International best practice suggests service level consistency and guarantees are important to investors. While existing investors in Lesotho deem levels of infrastructure provision as 'good', there is a range of views across sites and service types. According to investors surveyed in 2014, private services, such as telecommunications are often viewed as unsatisfactory, while water, waste and energy service provision are inconsistent (Buro Happold Engineering Eunomix & DNA Economics, 2014). The possibility for private developers taking on public services roles is unclear, as all electricity, water and waste treatment in Lesotho are currently provided by state owned enterprises Lesotho Electric Company and WASA.

Water is a critical factor for the proposed SEZ sites, especially given the potential agro-processing focus. Existing water supplies are largely provided by the Water and Sewerage Company (WASCO) under the oversight of the Lesotho Electricity and Water Authority (LEWA). Investors in Lesotho's existing industrial estates source water from a combination of WASCO facilities and on-site boreholes (Buro Happold Engineering Eunomix & DNA Economics, 2014), with many providing their own wastewater treatment facilities (especially in the denim textile industry).

Despite the extensive water resources of the country, a lack of infrastructure has reportedly led to acute water shortages which have threatened factory operations (World Bank, 2018). Boreholes are an unsustainable solution to this problem and do not address the needs of large companies. Foreign investors are not aware of the planned infrastructure investments which the Government are seeking to implement, and factories are likely to close if water shortages are not addressed in the near future (World Bank, 2018).

Electricity in Lesotho is largely supplied by the Lesotho Electricity Company (LEC) under the oversight of the Lesotho Electricity and Water Authority (LEWA). A 2017 study by the World Bank Investment Plan for Lesotho, identifies barriers to private sector investment in renewable energy which include:

> "*regulatory and institutional barriers such as an incomplete legal and regulatory framework, overlapping institutional mandates of various energy sector entities, and the lack of technical standards on renewable energy installations and appliances that creates an uncertain investment climate for RE investors and development*".

LNDC has a programme for public maintenance of common areas in its estates, providing such value-added zone site management services as security, waste management, and even LNDC provision of off-grid electricity generation. Such services could also be offered, on a contractual basis, by LNDC (and perhaps other parties) to private zone operators.

Box 7 Land designation for SEZs

The availability of land for both private and public, national and foreign developers is a key issue for any effective SEZ regime. As geographically demarcated areas, zones rely on physical access to land within a host economy. A pressing question at the launch of any SEZ regime concerns how land is acquired, by whom and whether this an efficient or costly process.

Lesotho's Land Act provides relatively clear property right and guarantees for zone developers. Field research found that the Land Act successfully provides a legal framework for private property development and management, enabling the sale (or at least long-term lease) of land and related assets to potential SEZ developers and end-users.

In relation to SEZs, there are three models for acquiring land.

1) A private company purchases from landholders;
2) LNDC acquires land either on its own or through declaring land as an area of 'national significance'; and,
3) Landholders lease land collectively through farmers company or land trust, which aggregates individual land parcels.

For foreign ownership of land, specific criteria will also need to be met. While Basotho can own or lease land, foreigners can only lease it. However, Basotho-majority companies with greater than 20% Basotho equity and no foreign directors can also own land purchased on the secondary market. The company's foreign shareholders would need to appoint Basotho company directors to represent them, under agency contracts to meet these criteria. In theory, a company which is 80% owned by a foreign corporate entity would be able to acquire land. Difficulties in interpretation of the law have apparently so far resulted in refusal of requests for foreign ownership.

Where foreign ownership prevents purchase of land, the government will be relied upon to sub-let land to private developers. The current LNDC industrial estate model allows LNDC to sub-let land under its control, which it holds in leasehold from the Crown. As a result of complicated terms for foreign companies, it is likely that the government will play a vital role in acquisition of land for SEZ development.

There is no clear Government appetite for introducing a comprehensive and integrated SEZ land use regulatory framework. This would grant a dedicated SEZ Authority coordinated authority over flexible and streamlined planning and controls, including such international good development control practices as 48-Hour, single-step land use/building permit issuance, and fast-track environmental permitting for smaller projects within SEZs. The Authority would need to be responsible for monitoring compliance with SEZ land development and related Developer Agreement and land-lease contract terms.

6 Regulatory and institutional framework

6.1 Global SEZ best practice

A clear regulatory and institutional framework, setting out the roles of key stakeholders and the procedures for developing and operating a zone, is a cornerstone of an effective SEZ regime. Zones typically have a unique position in any economy due to their distinct regulatory regime (United Nations Conference on Trade and Development, 2019b).[16] However, despite the necessary approval of an SEZ by governments, their development and day to day operation is often led by a variety of public and private sector actors. The multitude of stakeholders typically involved in an SEZ regime is complex and can be a key source of uncertainty. To increase predictability for investors, an SEZ regime benefits from laws that clarify the rights and obligations of zone stakeholders, set out in Table 12, and detail the steps for establishing, operating and regulating zones. Ideally these frameworks will seek to facilitate coordination across stakeholders, recognising their differing mandates and technical capacities. This provides clarity over the institutions and laws that will impact SEZs at every stage of their development.

6.1.1 Institutional structure for developing and operating SEZs

Key stakeholders commonly involved in an SEZ regime are set out in Table 12. Though the exact approach will vary according to a country's institutional context, selected key roles and responsibilities that should be designated to specific actors within the country.

[16] A distinct regulatory structure is not a prerequisite for an SEZ, but it is a common characteristic that makes zones special relative to the rest of the host economy

Table 12 The role of SEZ stakeholders

SEZ stakeholder	Responsibilities
Government	• **establishes SEZ policy and laws** • **authorises an SEZ** within a geographically demarcated area
Regulator	• **designate SEZ land,** following on from strategic planning and prefeasibility studies • **authorise licenses for zone developers / operators,** who can be public or private actors • **facilitate government services in zones** including licensing, permitting and regulatory services e.g. business licensing, environmental permitting, labour regulation, dispute resolution. • **monitor compliance** of activities in zones according to the SEZ legal framework, and issue penalties where appropriate
Developer	• **provision of zone infrastructure** e.g. waste disposal, road networks • **creation of zone masterplan**, which specifies the use of land within the zone e.g. zonal planning • **development of a zone's land prior to construction** according to the master plan e.g. land grading and levelling
Operator (responsibilities of the developer which can be sub-contracted)	• **management of lease and rental agreements** between investors and the developer of the site • **provision of services within a zone, including utilities (electricity, gas, water, telecommunications)** and a range of other business support services e.g. training, child-care, security, recruitment • **promotes a zone, often with support of government agencies** • **authorises zone users**
Investor	**invests in a zone, providing economic activity**

Source: Vivid Economics based on PwC, 2018

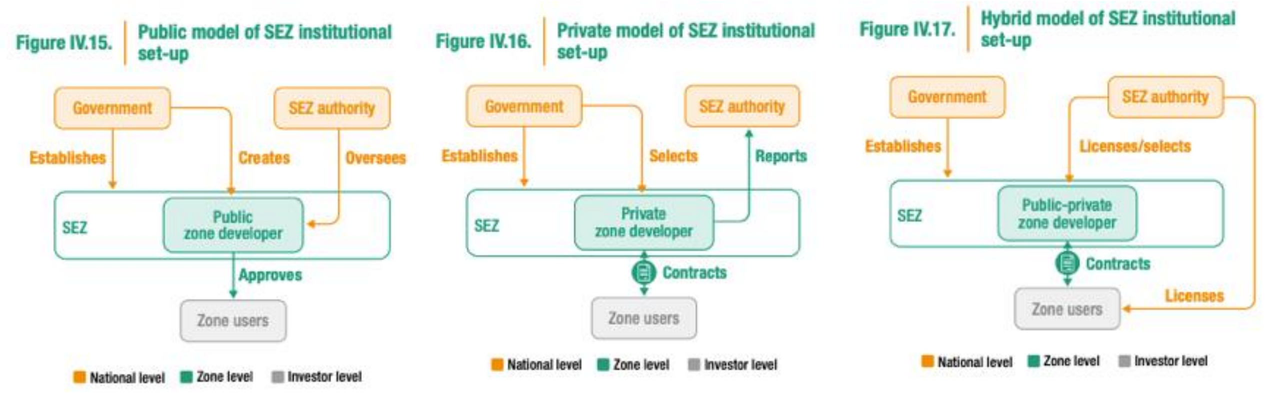
An SEZ regime is always a government-led effort. The government is the essential actor across any SEZ regime. Through creation of an SEZ policy they identify the purpose of zones, the laws that apply to business activity within zones and the regulatory process for authorizing SEZs. They also specify the institutional set-up of a zone by assigning responsibility of activities in Table 12 to government agencies or allowing for private sector involvement.

A standalone SEZ authority is best placed to act as an independent regulator. A clear distinction between regulators and developers is essential, especially where private development (either pure-private or as part of a PPP) is desired. When entities act as both regulator and developer or operator conflicts of interest, confusion about goals and responsibilities, and skill gaps can result.[17] The government is best placed to fulfil the role of SEZ regulator, helping to ensure land designated to SEZs aligns with national spatial planning and facilitating regulatory services to a zone. Independent SEZ authorities have been developed in Bangladesh, Botswana, Kenya, Kuwait, Malaysia, Nigeria, Pakistan, The Philippines, Qatar and Rwanda, for instance. Other models do

[17] Gauthier (2014) *Legal and institutional framework for SEZs*; http://www.wepza.org/s/Final-SEZ-Legal-and-Institutional-Framework-Mexico-VC-Gauthier-for-WEPZA.pptx

exist: in Ethiopia, the regulations which established the Industrial Parks Development Corporation require the Government to designate a supervising authority of the corporation (Azmach, 2019). In Zambia, the Zambian Development Agency is mandated to administer, control and regulate Multi-Facility Economic Zones, which it is also mandated to develop. In South Africa, the SEZ Act (2014) establishes an SEZ Advisory Board[18]. However, UNCTAD model institutional structures for all types of SEZ separate the regulatory and development responsibilities.

Figure 17 Model institutional frameworks identified by UNCTAD separate development and oversight functions



Source: UNCTAD World Investment Report 2019

The SEZ authority needs influence over other government entities. Reducing the regulatory burden and providing access to infrastructure and utilities often requires the involvement of multiple agencies. An SEZ authority needs to be able to influence other government ministries and agencies to ensure no bottlenecks are created. This ensures the integrity of the regime and delivery model, provides reassurance to private sector investors and developers, and streamlining of the investor-government interface. [19] This is often achieved by ensuring the SEZ Authority is represented at cabinet level. For example, in Qatar, the Chairman of the Board of the Qatar Free Zone Authority is also a Minister of State.

Irrespective of the type of development model, an interagency committee also ensures the efficient delivery of services across private and public actors. Regardless of whether a country has a public or private developer, the efficient delivery of hard and soft infrastructure that investors require within a zone, ranging from utilities, waste management and skills training, require the support of multiple government agencies. The capacity of an SEZ authority can be increased through creation of an inter-government committee, with the collective mandate to influence the provision of land, business licenses and access to foreign labour, among other necessary ingredients to a competitive zone offering. Typically, the overlapping skill sets required in providing licenses for different SEZ programmes implies that the roles ought to be merged under one regulating agency. Economies with successful SEZ regimes that have often relied on formal institutional coordination to expedite the provision of core SEZ incentives (PwC, 2018). Singapore is one example, that has utilised tripartite workforce committees involving SEZ investors to improve the attractiveness of the local workforce. Kenya, South Africa and Rwanda more recently have established inter-agency SEZ committees to help ensure the reliable and fast delivery of services within zones.

[18] https://www.thedti.gov.za/industrial_development/sez.jsp
[19] Gauthier (2014) *Legal and institutional framework for SEZs*; http://www.wepza.org/s/Final-SEZ-Legal-and-Institutional-Framework-Mexico-VC-Gauthier-for-WEPZA.pptx

Box 8 CASE STUDY: governance model adopted by Kenya's new SEZ programme

Following a change in national strategy, the Government of Kenya renewed their SEZ policy in 2015. Until 2015, Kenya operated under the Export Processing Zone Act passed in 1990. A lack of harmony over the aims of SEZs and national industrial policy, and coordination challenges across institutions, obstructed the success of the Export Processing Zones. In the wake of a change in national strategy, the new SEZ policy in 2015 sought to refresh objectives and overcome previous issues faced by the country's EPZs.

Kenya's revised SEZ program benefits from a clearer vision, targeted to a few objectives explicitly aligned with national strategy. The 2015 SEZ Act aims to provide a favourable environment for FDI, leverage exports for foreign exchange generation and help to diversify activity towards more diverse agricultural production. It explicitly aligns with Kenya's National Export Development and Promotion Strategy 1917-22, which increases the likelihood it will be able to achieve linkages between any future national and SEZ level reform efforts.

A dedicated SEZ authority is central to the new model's value proposition, helping to ensure zones are attractive investment locations. Kenya's SEZ Authority was established to enhance autonomy and cross-government coordination in relation to SEZ development. It is administered by a Board of Directors and its Chairperson is appointed by the President, which helps to guarantee close ties to high levels of government. The Authority's role as SEZ regulator includes responsibility over the design and development of SEZs across the economy. Accountability over its role is enhanced through the SEZ Act, which specifies the Authority's functions. These include:

- advise the Cabinet Secretary of Industrialisation on which areas to declare as SEZs;
- facilitate SEZ approval and operations amongst different stakeholders;
- promote investment by designing and regulating SEZ incentives;
- act as a one-stop-shop where enterprises can channel all of their applications for permits and facilities (not handled directly by the Authority); and,
- implement policies and programmes of the Government of Kenya's National Development Strategy.

Sources:

http://www.invest.go.ke/special-economic-zones/
https://assets.kpmg/content/dam/kpmg/ke/pdf/tax/analysis-of-the-special-economic-zone-act.pdf
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6.1.2 Development models for SEZs

Public sector involvement in the development of a zone can vary widely, with an increasing number of zones opting for greater private sector involvement. Whilst historically, the public sector was often the sole SEZ developer, responsible for establishing and financing a country's SEZs, there has been a trend towards greater private sector participation. Although only 25% of zones in developing and transition countries were privately developed in the 1980s, by 2008 this share was above 60% (World Bank Group, 2008). Kenya, for example, has transitioned away from state-led and operated sites through their new SEZ programme, Ethiopia is seeking to divest operation of publicly developed zones, such as Bole-Lemi (PwC, 2018), and in Vietnam, 5,000 foreign firms are located in SEZs predominantly led by the private sector (Tyson, 2018). This trend results from constrained government finances and low levels of public sector technical expertise amongst developing economies. The wide range of models for developing a zone are illustrated in Figure 18.

To the extent that the private sector can offer greater technical and financial capacity, fully private or PPP development and operation models are recommended. Private participation (and indeed ownership) usually drives greater market orientation, industry knowledge and expertise, access to private capital, customer service levels and innovation. Evidence suggests that private sector participation in parks has also specifically brought efficiencies in overall financing, construction, and operation (Tyson, 2018). Where the prevailing business environment is conducive and market attractiveness high, park development can occur without significant support from government beyond approval of regulation. In general, private or PPP models are preferable to publicly driven industrial park development and operation, wherever possible.

Public-Private Partnership (PPP) models are a particularly attractive option to catalyse private sector engagement in countries where the commercial returns from zones are less certain. The large upfront investment required to develop a zone and the long-time frame before a site is fully operational create risks for any zone developer. These risks are heightened wherever the commercial attractiveness of a country's SEZ regime has not yet been demonstrated, and concerns over macroeconomic and political stability exist. Governments typically have a higher risk tolerance than the private sector, and PPPs can help to mitigate risks for private developers. Across Africa, PPPs have encouraged private sector involvement in national SEZ regimes, including Lekki Investment Co. Ltd in Nigeria and PEZ in Rwanda. A PPP model also presents an opportunity for governments to retain a degree of control over investment activity in zones, through veto voting powers.

Figure 18 Commonly used models for developing a zone

Source: Vivid Economics based on PwC, 2018

Clarity over processes for identifying and developing SEZs and an understanding of the role of government is essential help to facilitate private sector participation. To encourage private sector involvement will also require clear regulatory processes for the licensing of SEZ developers and operators. These should set out the role of government and the steps that private developers must take to launch an SEZ. Provision of a standardised feasibility study can be a minimum requirement used to assess all SEZ developers.

Operation of zones typically benefits from the technical expertise of private management companies. Although the day-to-day operation of zones is commonly managed by the zone developer, the role can be designated to a separate entity. Operators ensure ease of doing business in a zone is maintained. They are responsible for providing basic infrastructure services, such as electricity and waste management, and commonly extend their role to providing additional business support services, such as training centres. They are also responsible for promoting a zone and attracting investors.

Box 9 Best practices to encourage outcome-oriented private sector PPP investment

To achieve positive returns for government through the development of zones, PPP deal structuring should follow best practice at every stage.

In the first stage, the government should provide market clarity to attract high quality private investors by:

- **procurement tracking,** in order to provide market clarity. This includes information on pipeline projects; their objectives; whether they are publicly or privately financed; timelines; precise site location; business cases; procurement status in process; and past project performance and cost benchmarks;
- **development of draft terms of engagement** with private sector, which provide standardised transparent contracts; and,
- **pre-procurement market engagement.** This can include the announcement to the public of the procurement timeframe; early-stage interaction and consultation through "User Groups" and "Developer Business Roundtables" open to potential bidders; project workshops and pre-bidding conferences; and, a dedicated Dialogue Team accessible through an online portal.

In the second stage, consistent, market driven evaluation should help to select the most appropriate private investor and project, through:

- **competitive tendering,** to ensure best value, innovation, cost savings and efficiency**;**
- **lean bidding,** to improve participation. This implies streamlined procurement timeframes of under 18 months;
- **pre-qualification of interested parties,** with weighted scoring on relevant criteria, such as financial stability, relevant experience and technical capacity;
- **market-tested evaluation requirements** of bids which review experience in construction and integrated facilities management; risk assessment and mitigation plans; financial modelling; marketing plans; project staffing plans; and site operational plans;
- **informal project market testing** through structured questionnaires and follow up interviews of potential private partners; and,
- **feasibility assessments** drawing heavily on market views.

Finally, capacity and processes to deliver positive outcomes should be enforced in advance, through:

- **assembly of deal delivery team,** including specialist external advisors; and,
- **contract monitoring and review mechanisms**, which ought to include project or contract Monitoring Unit with permanent staff; monthly developer reports; annual user satisfaction surveys and, or, third-party performance assessments; and annual contract reviews.

Source: Locus Economica

Bilateral and multilateral partnerships can be a key driver of SEZ development by providing finance and leveraging expertise to develop globally competitive SEZs. For example:

- the World Bank Group's Multilateral Investment Guarantee Agency provides investment guarantees to eligible foreign investors[20] and in 2000 provided guarantees for over USD 20 million in investments to partially privatise the Lesotho government's vehicle pool;[21]
- the Development Bank of Southern Africa has several project preparation programmes specifically targeted at developing industrial infrastructure in SADC countries, including a dedicated desk focussing on support for Industrial Parks and Special Economic Zones. The bank's Project Preparation Fund supports 'pre-feasibility studies, bankable feasibility studies and assistance with costs to reach financial close';
- the African Development Bank's private sector window has been used to fund SEZ preparatory studies (including this report) and downstream project development through both loans and grants; and,
- bilateral programmes such as DfID's Invest Africa and UK private sector collaboration through the CDC Group, GIZ's support to the African Union's Programme for Infrastructure Development in Africa and JICA's delivery of SEZ projects in Kenya are all examples of development partner interest in promoting industrialisation and investment through SEZ development.

SEZ development supported by Chinese development companies and state-owned enterprises have become increasingly popular in Africa. China has stated an intention to invest USD 100 billion in Africa by 2025, up to 80% of which will come through support from the Exim Bank of China. This model of development has been effective in many cases in providing finance and capacity to develop infrastructure that would not otherwise be feasible, but there are some key lessons to take away from countries that have worked with state-supported Chinese developers in the context of SEZ development (Tyson, 2018).

Box 10 CASE STUDY: Financing Ethiopia's industrial parks

Ethiopia raised finance for its industrial development parks through the issue of USD 1 billion in international sovereign bonds (USD 750 million of which was earmarked for industrial parks), making it the first Least Developed Country to do so (Tyson, 2018). The Hawassa Industrial Park is recognised as a flagship example of Ethiopia's industrial parks initiative, featuring zero-liquid discharge technology for its textile manufacturing industry. Infrastructure finance has been provided by the World Bank, AfDB and Chinese Exim Bank to develop a road connection between the park and nearby markets.

Many of Ethiopia's private sector-led zones have been developed by Chinese contractors benefitting from Chinese government support. China's Ministry of Commerce provides long-term loans, subsidies and grants to these companies, including 30% funding for pre-construction and implementation costs (though san be as much as 40% of total investment). Further guarantees are offered by parent companies and Chinese public export banks. These benefits allow Chinese companies to outcompete other developer offers on price terms. Host government requirements include favourable land leases and infrastructure provision (Tyson, 2018).

Standard sole-sourcing requirements attached to many Chinese loans may drive up development costs. Ethiopia's Adama development is financed by China Exim Bank and developed by a Chinese company with a per hectare cost of USD 3m/ha (compared to USD 0.1-0.6 m/ha for 11 industrial parks and SEZs analysed

[20] Investors must reside in one of the 181 MIGA member countries, individual cross-border investment guarantees are issued for 3-20 years and capped at USD 220 million for an individual project and USD 720 million for a country portfolio. Excluded sectors include 'illegal drugs' which is likely to be interpreted to include medical cannabis projects in Lesotho.

[21] https://www.miga.org/project/imperial-fleet-services-lesotho-proprietary-limited

in East Africa) (PwC, 2018) . Anecdotally, non-Chinese developed parks have come in at a third of the cost of Chinese-developed parks in Ethiopia.

Considering the full portfolio of Chinese FDI in Africa[22], investment has to date been largely concentrated in extractive, infrastructure and primary commodities, rather than in manufacturing or diversification-enabling sectors. The specific terms of financing offered tend to be relatively expensive (c. 3% higher interest rates than the industry standard, as represented by the London Interbank Offered Rate). There are no examples of systematic wider impacts driven by Chinese FDI, including structural change (Geda, 2018).

In some cases of Chinese-supported SEZ development and operation, investment level requirements set out contractually have not been met due to financial restructuring activities passed down to developers by parent companies and financiers. These barriers to delivery are more significant amongst Chinese developers given their corporate structure and short-term responsiveness to central policy direction. Potential safeguards to this risk include setting out penalties/opening of terms for shortfalls in investment delivery and clearly specifying legal terms (e.g. third-party arbitration under English/South African law) (Tyson, 2018).

Sri Lanka's SEZs have been financed by c. USD 25 billion in Chinese loans from state-owned banks and delivered with construction and operations contracts with Chinese firms. Benefits for Chinese companies include USD 1.4 in investment and tax breaks for the China Communication Construction Company. The USD 15 billion 'Port City Colombo' project has so far underperformed, preventing the Sri Lankan government to fall short of debt service obligations and in turn provide Chinese firms extended leases and debt for equity swaps (Tyson, 2018). This example highlights the importance of due diligence and robust projections in deal structuring.

The China Civil Engineering Construction Company (CCECC) has been a key strategic partner in implementing Chinese investment in Africa, including as the developer of Ethiopia's Hawassa Industrial Park. Subsequent analysis of Hawassa's infrastructure has identified gaps including: 1) an inadequate supply and standard of housing and basic services for residents, 2) insufficient safety provision including incorporation of police stations and street lighting into residential areas, and 3) a lack of adaptable Human Resources practices and management to attract and retain a high quality workforce.[23] These lessons may point to areas that should be scrutinised by Lesotho SEZ regulators where relevant in negotiations with potential developers.

6.1.3 Legal, regulatory and policy framework for SEZs

There is no single set of policies that characterize SEZs globally. Each country has chosen to introduce incentives and measures that are often considerably different from each other. However, most SEZs permit all companies registered and operating within their territories access to a single set of incentives. Typical policies offered by these zones are summarized in Table 13.

[22] Estimates range from USD 24 – 61 billion in FDI stock as measured in 2018

[23] Presentation given by Nayeem Kashem of Enterprise Partners in London 17 July 2018

Table 13 Common areas covered by SEZ-specific policies

Policy	Description
Corporate taxation	Low flat tax applied on a territorial basis; normal taxes on income gained from transactions in the domestic customs territory
Eligible activities	Registered firms can undertake all types of economic activities
Retail sales	All merchandise can be sold on a duty- and tax-free basis within the zone
Sales to domestic market	Registered firms can sell freely to domestic market on duty- and tax-paid basis
Consumption of merchandise	Uncontrolled consumption of merchandise within zone
Eligible activities	Registered firms can undertake all economic activities
Immigration and residence	Investors and families can reside within the zone
Foreign workers	Registered firms are allowed to recruit foreign workers
Land use and development	Special land use and development controls prepared for zone
Utilities and infrastructure provision	Full deregulation of utility services, transportation services

Source: Locus Economica

Most SEZs are fully consistent with World Trade Organization (WTO) requirements.[24] They do not have a mandatory export requirement; do not impose local content requirements; nor do they discriminate among activities in terms of access to incentives. Firms can undertake any (lawful) economic activity and freely sell to the export or domestic market.

Establishing an SEZ regime can be a complicated and lengthy effort. There are several policy concerns with SEZs. The most important of these are the following:

- **tax policy distortions.** There is a concern that firms may locate within an SEZ to escape normal taxation. This is often controlled by subjecting all income derived by firms from transactions with the domestic market to prevailing, national corporate taxes; and,
- **impact on small economies.** A large-scale SEZ may have a significant impact on a small country, potentially causing distortions in the policy environment. The experience has been that SEZs have a positive policy impact, accelerating reforms in the country overall.

[24] Except for some export processing zones (EPZs) which are more likely to violate state-aid rules under set out by the World Trade Organisation

Box 11 Complying with international trade rules in SEZs

The WTO Agreement on Subsidies and Countervailing Duties (SCMA), Article 3.1, generally prohibits Member export subsidies. These prohibited export subsidies include tax incentives combined with export requirements (SCMA, Art. 1,1.1(a)1)ii)), as are often seen in EPZ programmes. Articles 1 to 3 of the SCMA describe prohibited and actionable subsidies, and Annex 1 contains an illustrative list of export subsidies. These broad definitions are further refined in Part II (Article 3) and Part III (Article 5) of the SCMA, which specify that prohibited subsidies are those that are contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance.

However, Article 27.2 of the SCMA allows LDCs (including Lesotho) to ignore the SCMA export subsidies prohibition. LDCs recognised by the WTO are those countries which have been designated as such by the UN. The assessment of LDC status is performed by the UN's Committee for Development Policy (which reports to Economic and Social Council) on a rolling three-year basis (the Triennial Review), last conducted in 2018. The assessment employs three criteria: a country's Gross National Income (GNI) per capita (which must not have reached USD 1,000 in constant 1990 USD), Human Assets Index ("HAI", a composite index based on infant and maternal mortality rates, nutrition indices, and education and literacy rates), and Economic Vulnerability Index ("EVI", a composite index based on population levels, primary sector dependence, incidence of natural disasters, and export concentration and stability). Current lists may be consulted here: https://www.wto.org/english/thewto_e/whatis_e/tif_e/org7_e.htm and https://unctad.org/en/PublicationsLibrary/ldcr2018_en.pdf.

Lesotho's current HAI score is 61.6, while the graduation score is of 66 or above. Furthermore, its EVI score is of just 42, while the graduation score is of 32 or below. However, its current GNI is already above the current graduation level of USD 1,242.

Thus, Lesotho should be wary of including any export subsidies (such as tax breaks tied to exports) within any SEZ incentives as it may not retain its exemption status with WTO and could be subject to penalties for any noncompliant subsidies.

Source: Locus Economica (2019)

Significant decisions must be made on the core set of policies typically encompassed within an SEZ regime, which cover:

- trade and customs (including origin certification; import and export policy; relationship with global and regional trade agreements; valuation; duty treatment on local sales; transit and transfer procedures; consumption; storage and auditing);
- taxation and incentives (corporate and income taxation; double taxation avoidance agreements; sales or value-added taxes; indirect taxes; withholding taxes; WTO compliance);
- investment (including investment licensing; business registration; foreign investment protections);
- labour, immigration and residency (foreign worker entry; permanent residence privileges; labour regulations and dispute resolution);
- planning and private infrastructure provision (including land use planning; ownership and property rights; licensing; development controls; environmental controls; utilities and infrastructure provision; regulation); and,

- transportation (regulation and policies for all forms of transportation services and concessions within the zone).

In each of these areas, the government must assess whether existing laws and regulations accord with international "best practices," or whether new policies ought to be introduced within the SEZ. Because an SEZ touches on so many cross-sectoral issues, broad consultation with all parts of government and the private sector is involved.

The SEZ policy regime should offer a bold vision for a modern, integrated policy regime to be implemented to accelerate and diversify investment. Given that SEZs are inherently designed to provide world-class, liberalised investment environments across the widest possible cross-section of economic activities, SEZ Laws generally tend to deal with many areas of Government service delivery, including most of the issues summarized in Table 14.

Table 14 Issues typically covered in an SEZ law

Policy area	Specific issues
Business licensing and registration	• Incorporation • Company Registration • Commercial Licensing • Municipal Licensing • One-Stop-Shopping
Regulation of labour	• Work Contracts • Work Permits • Work Visas • Collective Bargaining • Social Security Employer Registration, Reporting & Payments • Social security Labour Registration • Labour, Occupational Safety, and Welfare Norms • Inspections • Termination • Labour Dispute Resolution
Regulation of import and export	• Customs Clearance • Customs Duties & Import Taxes • Import & Export Permits • Certification of Origin • Import & Export Standards • Tax Rates, Incentives & Incentives Acquisition • Municipal Taxation • Tax Accounting, Reporting & Payments
Land use planning, development and building guidelines	• Land Acquisition • Title Registration • Development, Roadwork, Run-off & Drainage, Electrification & Street Lighting Plans Approval • Cadastral Registration of Changes • Construction Permits • Control of Works • Fire Clearance • Health & Safety Clearances • Occupancy Permits • Potable Water & Waste-water connection s • Electricity connection • Industrial Gas connection • Telephone & Data Transmission connections • Continuing Safety Inspections • Development Impact, Emission & Effluent Norms • S-EIA & SEI Mitigation Plan Approval • Regulation of Private Infrastructure & Transport Services • Potable Water Concessions & Waste-water Treatment Licensing • Waste Disposal & Management Licensing • Industrial Oil & Gas Licensing • Power Generation & Transmission Concessions • Telecommunications Licenses & Concessions • Power Distribution Concessions
Resolution of commercial disputes	• These issues are generally handled by the national court system and arbitration fora

Source: Locus Economica

Box 12 Aqaba SEZ Legal and Regulatory Framework

The following table demonstrates which SEZ regulatory issues international practice suggests should be dealt with in the SEZ Law and which should be delegated to regulations, based on the example provided by the Aqaba SEZ in Jordan:

Express in SEZ Law	Delegates to SEZ Regulations	References & retains national Law
Incorporation Foreign Investment Registration Local Trading Licensing Work Contracts Work/Residency Permits Work Visas Purchase of Public Land Purchase of Private Land Title Registration Land Use/Zoning S-EIAs Construction Utilities Ports Private Utilities Foreign Exchange Import/Export Clearances Certification of Origin Tax Incentives	Incorporation Foreign Investment Registration Local Trading Licensing Work/Residency Permits Labour Safety Purchase of Public Land Development Approval Land Use/Zoning S-EIAs Construction Utilities Ports Private Utilities Import/Export Clearances Certification of Origin Financial Services Internal Commerce	Incorporation Foreign Investment Registration Local Trading Licensing Work Contracts Work/Residency Permits Work Visas Withholdings Social Security Labour Dispute Resolution Labour Safety Purchase of Private Land Title Registration Import/Export Clearances Certification of Origin Tax Financial Services Internal Commerce

Source: Locus Economica

An Agricultural Free Zone (a.k.a., Agroprocessing Zone, Integrated Agro-Food Park) is a designated site for agricultural, horticultural, agro-forestry/wood processing, aquaculture or agro-pastoral value-addition activity. They have been implemented in Brazil, India, Botswana, Kenya, Cameroon, Ghana and Ethiopia, amongst other countries. Some integrated agro-food park (IAFP) best practice policy elements that emerge from global thought leadership around the concept and its application include:

- Eligibility to agri-sector extension services, agricultural agglomeration, processing, commercialization, transport, distribution, and other agri-sector activity, including agricultural machinery MRO, third-party processing, packing, and transport. Equal treatment with agro-processors, within SEZs, for upstream fertilizer and animal feed related activity, agri-finance, insurance, commodities exchanges, input suppliers, agri-dealers, weeding/cutting/planting contractors, extension services, tropical medicine research, and warehouse receipts centres;
- Rules for intellectual property right (including Protected Plant Variety) registrations;
- Enhanced biosafety, food safety, and sanitation regulations;
- SEZ Authority, in collaboration with Ministry of Agriculture, prescribes modalities of and provides for enabling policies as regards agricultural research and development;
- Preventative and risk-based control procedures that comply with internationally recognized practices such as Good Agriculture Practices (GAP), Good Manufacturing Practices (GMP), Good Hygienic Practices (GHP) and HACCP[25], ISO 22000 and other relevant ISO standards; and,

[25] Hazard Analysis and Critical Control Point standards for food safety

- Inter-agency SLAs for onsite presence of:
    - ◊ Quality, Product, Process, Standards, and Trade Certification services onsite;
    - ◊ Ministry of Labour, Ministry of Agriculture, and recognized specialised technical training institutions / extension services;
    - ◊ R&D, patenting, and product commercialization services, in conjunction with recognized universities and/or legal services providers; and,
    - ◊ Quarantine, laboratory services and facilities, and SPS advisors.

Establishing dispute resolution mechanisms are key to provide a secure and trusted business environment for foreign investors operating in SEZs. The rule of law is the most fundamental condition underpinning a modern market economy. In their protection of business and contractual rights, dispute resolution systems must be impartial and credible to investors. Contract enforcement needs to be fast, fair, and affordable. Justice delayed is justice denied. From the standpoint of investment promotion, transparency and equity in dispute resolution systems are thus essential elements. To stimulate economic growth through private investment, commercial justice must be effective and speedy as well as non-discriminatory.[26]

Where formal dispute settlement processes may be slow, uncertain or expensive, developers and enterprises subject to the SEZ law may require a more efficient and equitable mechanism to resolve legal disputes. Alternative Dispute Resolution (ADR) involves a voluntary decision by parties to submit disputes to third party and comply with its decision. Its primary advantages stem from its accuracy, cost, speed, and lesser contentious nature.

Many zones provide a "first instance" internal dispute settlement procedure to bring disputes to the regulator and then to its Board of directors.[27] The SEZ Authority's Board may convene a panel of public and private sector representatives, including other enterprises, to hear evidence and adjudicate the dispute. Such decisions are typically non-binding, with either party free to refer the dispute to arbitration or the local judiciary. These frameworks, where they conform to good practice, are streamlined and timebound.

SEZ enabling legislation often "pre-binds" all Government parties with any role in SEZ regulation or operation to arbitration. Good SEZ arbitration frameworks remove restrictions on arbiters, governing law and forum of decision; narrow or eliminate permitted court challenges; and ensure enforceability, including for international arbitration. As such, they make UNCITRAL, ICSID and the 1958 New York Convention on the Enforcement of Foreign Arbitral Awards rules available to and applicable to parties within SEZs, and (in addition to providing structured access to local arbitration) guarantee access to international arbitration through such internationally recognised commercial dispute resolution forums as the International Chamber of Commerce in Paris and the London Court of International Arbitration , the business communities' two preferred global forums for resolution of disputes.

Robust SEZ ADR frameworks provide substantial coverage of potential dispute scenarios. These include purely commercial disputes between two private parties, to labour disputes between zone users, and between different government entities amongst themselves.

[26] Locus Economica (2019)
[27] Locus Economica (2019)

6.2 Lesotho's gaps relative to best practice

6.2.1 Institutional framework

Across Lesotho's current industrial estates, LNDC takes the responsibilities as developer, operator and investment promotion officer, under the governance of MTI.[28] LNDC is currently responsible for all stages of industrial estate development. In existing industrial estates, they prepare site feasibility studies, finance infrastructure and superstructure development, see to the management of facilities and provide investment facilitation and aftercare to occupants. Its efforts as operator and investment facilitator are supported through the Strategic Business Units of Property Development and Management and Investment and Trade Promotion department, respectively. Under the LNDC Law, the development of industrial estates is subject to oversight by MTI and MoF, which approve LNDC's development plans and provide financing for capital infrastructure through the national budgeting process. LNDC does not, however, have policymaking or regulatory authority or capacity, being subject to oversight from the Ministry of Trade and Industry (MTI) and Ministry of Finance (MoF).

The institutional framework in place for Lesotho's industrial estates allows for a disconnect between development of estates and the operation of a sustainable financial model[29] **in those estates.** LNDC is experienced in attracting international investors towards Lesotho's Industrial Parks and in coordinating the development of factory shells and estates. However, the agency's high levels of rental arrears impede its ability recover funds to support the capital infrastructure costs in its estates and continue to develop additional industrial estates. Below-market rental rates crowd out private investment outside of the estates, further distorting the government's ongoing private sector development initiatives.

6.2.2 Delivery models

Considering these challenges, LNDC is interested in increasing private sector participation in the development of new industrial sites, but no competitive tendering process has been put in place. Field research highlights LNDC's interest in attracting private developers to develop zones, for example in Mafeteng and Berea, either independently or through PPP financing models. No competitive bidding process and bidding framework for land developers or the development of SEZs has been established. To date, discussions with potential developers have been bilateral and based on direct contracting. An MoU has been prepared with a potential developer for the Berea site, although it has been tabled pending the adoption of a clear SEZ policy. To attract private sector developers, the Government has also recently established a M 10 million (approximately USD 700,000) Project Preparation Facility with the aim of funding feasibility studies and project-structuring activities.

6.2.3 Regulatory framework

A number of existing policies that align with the basic best-practice requirements of a competitive SEZ policy. Table 15 provides this comparison by policy areas identified in section 6.1.3.

Table 15 Comparison of best practice policies to Lesotho's current policies

Best practice policy area	Existing Lesotho policies
Taxation	Competitive Consistent with good/competitive corporate taxation levels.

[28] Through a board of directors appointed by the Minister of Trade and Industry
[29] Inclusive of infrastructure costs

Best practice policy area	Existing Lesotho policies
Eligible activities (under LNDC Act and in general)	Competitive LNDC Act Sub-secs. 5(1)c), (e), (f), (l), (s), (aa) and 5(2), and Sec. 25, not entirely applicable to the question (as confer no specific incentives), but may be inferred as flexible.
Duty-free retail sales	N/A (no comparable programme currently on offer in current industrial estates or warehouses).
Sales to domestic market	Mixed situation. Available through bonded warehouses, however subject to bonds, whereas most competitor locations have bond-free SEZ programmes.
Consumption of merchandise	See **Duty-free retail sales** and **Sales to domestic market**.
Immigration and residence	WEF shows relative lack of competitiveness. Labour Code, Sec. 166 is restrictive. Work Permit Application & Renewal Form Questions 34-38 are restrictive.
Foreign worker entry	See **Immigration and residence**.
Land use and development	WEF shows relative lack of competitiveness. LNDC 2018-2022 Strategic Initiative 4.1.4 is to develop package of incentives for private development of industrial parks. Mozambique and Seychelles offer pre-built factory shells to investors. Poor cadastral coverage, no set timeframes (average 43 days) or administrative review mechanisms for title registration/transfer. 114 days for power connection; no compensation for interruptions. 30 days for water and sewage connections from WASA. 183 days involved in dealing with securing building and occupancy permits.
Private utilities and infrastructure provision	Mixed situation. Private provision possible under Water & Sanitation policy. Lack of defined IPP framework under Energy Policy 2015-2025 is constraining performance. Mobile telephony framework open to private licensees (Econet, Vodacom, etc.) but not delivering results. WEF shows relative lack of competitiveness.

Source: Locus Economica

Lesotho lacks a PPP Law. A PPP policy has been developed by the Ministry of Finance, but a permanent law is necessary to provide long-term certainty to investors and establish the institutional relationships for developing PPP projects that meet requirements of both public and private partners. Experience to date with formal PPP projects in Lesotho (e.g. those delivered through the Ministry of Finance's Private Sector Investment Committee) has been limited to projects negotiated with unsustainable terms for the government partner which has dampened support for these projects in the country.

There are a number of gaps between Lesotho's agricultural sector policies and best international agricultural policy practices. While the existing regime is not restrictive from a regulatory standpoint, neither does it proactively provide assistance to enable foreign investment in the sector. Table 16 includes a comparison on Lesotho's agriculture sector policies compared to global best practice.

Table 16 Lesotho agricultural policies relative to best practices for agro-food SEZs

Best Practice Agricultural Policies	Current Lesotho Policy
Equal policy treatment of agro-processors with non-processing activities (i.e., extension services, agricultural agglomeration, transport & distribution, agri-machinery MRO, packing, transport, fertilizer and animal feed, agri-finance & insurance, commodities exchange, input supplier, agri-dealer, weeding/cutting/planting, tropical medicine research and warehouse receipts centres)	LNDC 2018-2022 Strategic Initiatives (SI-2.2, SI-3.1.1, SI-3.1.3, SI-3.3.1, SI-3.3.3.) to develop "agro-projects" and "grower models", horticultural, agropastoral and agropescuary projects, and "related supply chains", including through market infrastructure, agro-parks, SEZs.
Plant Variety Protections	No law on Plant Variety Protection
Agricultural research and development	Limited in practice (part of future-state strategies and plans)
Product commercialisation services in conjunction with recognised universities	Ineffective government subsidies have stunted development of commercialisation services (MCC), except in forestry
In-factory/on-farm government services (SPS advisors, extension services, etc.)	Limited: SADC SPS standards and measures in process of harmonisation with 2019 target date; donor extension services proposed in certain value chains (e.g., MCC wool and mohair, possibly horticulture)

Source: Locus Economica

7 Recommendations for Lesotho's SEZs

This section presents recommendations for developing a globally competitive SEZ regime in Lesotho. These recommendations are based on international best practice for SEZs and should be implemented as a complete package to attract high-quality foreign investment in support of Lesotho's national economic development goals. However, the political economy realities in place for any national policy in any country must be recognised and these recommendations are unlikely to be completely adopted without debate and due consideration.

In light of the deliberative process that will likely accompany any SEZ development, there are a select number of characteristics of any SEZ regime that should be prioritised. These characteristics include:

1. first, a long-term policy commitment to attracting high quality foreign investment set out in an SEZ Act and supported through consistent and current government policies;
2. second, an internationally competitive incentive offering that reduces the cost of capital investment in an SEZ and facilitates expedient and effective regulatory support for foreign investors operating in an SEZ; and,
3. finally, a specified SEZ regulator for that is housed outside of ministry silos and empowered with the ability to expedite necessary regulatory processes to meet investor requirements, preferably through direct agreements with relevant ministries.

If these three conditions are supported by Government and communicated to investors, international experience suggested that the SEZs regime will be competitive to attract high quality capital investment to Lesotho. Without all three of these conditions being met, an SEZ regime is unlikely to succeed in Lesotho, and alternate policies should be prioritised, such as developing cost-effective industrial estates and improving the economywide ease of doing business.

7.1 Overview of recommendations

Based on the global practice and specific gaps identified for Lesotho in sections 3-6, this section provides a set of recommendations for an SEZ regime in Lesotho. Specific recommendations are provided for:

- SEZ strategy: including specific objectives and vision for the SEZ regime in Lesotho, geographical and sector focus, phasing and alignment with existing policies;
- investment incentive offering: including fiscal, financial, soft infrastructure and hard infrastructure incentives required to attract global investment in selected sectors; and,
- regulatory, legal and institutional structure: including governance and decision-making structures for SEZs and the regulatory framework to allow for their effective operation.

Table 17 summarises the recommendations described below.

Table 17 Summary of recommendations for an SEZ regime in Lesotho

Number	Recommendation
1	Lesotho should develop an SEZ policy which sets out a clear vision for Lesotho's future SEZ regime and the need for an SEZ Law, prior to the development of any new zones.

Number	Recommendation
2	Lesotho should, as a matter of urgency, finalise its national Industrial Policy, with the SEZ policy explicitly contributing to its objectives.
3	The objective of Lesotho's SEZs should be to maximise investment in high value production.
4	The objective of Lesotho's Industrial Estates should be explicitly stated as maximising employment.
5	The SEZ Policy should indicate priority sectors in manufacturing, but implementation should remain flexible and responsive to demand, including in the service sector.
6	Risk assessments should be undertaken to understand the impact of permitting investments in different sectors from locating within the SEZs.
7	SEZs should not be used as the primary tool for regional economic rebalancing.
8	Lesotho's SEZ strategy should be structured around the development of hybrid zones that are flexible to align with investor demand within the context of relevant policies.
9	Eligible investors should be free to locate within an SEZ or Industrial Estate.
10	SEZ development should be reflected in the National Spatial Strategy where there is investor demand for clustering and agglomeration.
11	Zones should be developed through a phased approach to allow room for growth, aligned with National Spatial Strategy timelines, including a pilot where there are credible development models in place (e.g. Mafeteng).
12	Learning and evaluation activities should be purposefully designed for both 1) pilot phase and 2) in regular intervals, such as the conclusion of a five-year policy.
13	Formal relationships should be developed with South Africa's SEZ programme, allowing partnerships with key zones in South Africa and those in Lesotho, allowing for facilitated inter-zone trade flows.
14	Fiscal incentives should be introduced to lower the effective tax rate in SEZs and encourage investment that raises productivity.
15	VAT and customs duties should be suspended on goods sold into or within the zone.
16	Lesotho should engage with international finance institutions to create a concessional finance facility for SEZ investments.
17	Lesotho should create an SEZ facility which contributes towards the costs of capital expenditure on technology, machinery and equipment, training, and research and development.

Number	Recommendation
18	Ensure internationally competitive levels of utility and infrastructure service to new industrial land sites (off-site and on-site).
19	Transition from the subsidised support of rents to funding enhanced shared infrastructure across LNDC portfolio.
20	Enhance border infrastructure enabling easier cross-border transit of goods and feedstock associated with the zones.
21	Consider land reforms enabling wholly private ownership of land (or long-term protected land leases) for SEZ investors and developers.
22	A one-stop-shop (extension of OBFC) should be established in each zone to provide a range of business support and regulatory services which are core to the SEZ value proposition.
23	Ensure the provision of business support services, preferably through engaging the private sector in a PPP.
24	An SEZ Authority should be established through an SEZ Act.
25	The creation of a favourable business environment in SEZs should be achieved principally through service level agreements with relevant ministries, authorities and parastatals.
26	Prioritise the development of a robust PPP law and policy framework in Lesotho.
27	An interim solution may be to establish an SEZ Unit in the Prime Minister's Office, with service level agreements between responsible Ministries and the LNDC (as a development partner).
28	The SEZ Authority Board should consist of key Ministers, with representation from the private sector, and chaired by either the Prime Minister of Deputy Prime Minister.
29	LNDC's role should focus on the promotion and development of SEZs
30	The full spectrum of public, private and PPP SEZs should be permissible
31	Private sector involvement in the development and operation of zones should be encouraged through a) legal eligibility of private developers in tenders for zone licenses, and b) government incentives to attract private developers through financing of feasibility studies and best practice PPP arrangements.

Source: Vivid Economics

7.2 SEZ strategy and vision

Recommendation 1. Lesotho should develop an SEZ policy which sets out a clear vision for Lesotho's future SEZ regime and the need for an SEZ Law, prior to the development of any new zones.

Recommendation 2. Lesotho should, as a matter of urgency, finalise its national Industrial Policy, with the SEZ policy explicitly contributing to its objectives.

A well designed SEZ regime is viable in Lesotho. The findings of this report support the development of SEZs in Lesotho as a tool for attracting high quality private investment in the target sectors. The review of investment opportunities and sector SWOT analysis shows that there are potential growth opportunities which would benefit from a well-designed SEZ offer. The experience of other countries, both across Africa and globally, shows that they can contribute to investment, employment, diversification, exports and economic growth. However, SEZs are neither a panacea nor a replacement for broader investment climate reform, and poorly designed or implemented zones are likely to fail.

Lesotho should set out a clear vision for Lesotho's zones through a comprehensive SEZ policy. The policy should indicate the commitment of the Government of Lesotho to the development of a competitive SEZ regime, with the allocation of sufficient financial, human and technical resources to ensure its success. The policy should provide a strong signal to potential SEZ developers on how SEZs are expected to contribute to Lesotho's national development objectives, and the type and level of support they may expect. This policy should be developed before the Government commits to establishing an SEZ.

An SEZ policy can help to increase the likelihood that future zones will have a positive impact Lesotho's economy through two key pathways:

- creating political buy-in and commitment to zone success. By setting out the role that zones will play in the national economy and demonstrating the government's long-term commitment to their success, an SEZ policy seeks to align incentives and enhance coordination across government; and,
- serving as an investment promotion tool. By detailing a clear value proposition of Lesotho's SEZs and creating a point of focus for investment promotion efforts, it helps to attract international investors.

A clear SEZ policy should adopt the recommendations of this report, and specifically include:

- SEZ objectives;
- the alignment of an SEZ regime with national and regional policies;
- the value proposition of zones, including the types of activities which they are best suited to;
- the incentive offering expected to be provided by zones, detailed in Section 7.3, and how it counteracts investment challenges faced in the wider economy; and,
- the institutional and regulatory framework of SEZs, detailed in Section 7.4, including the role of government and the private sector in zone development
- a timeline for 1) development of service level agreements with relevant regulatory ministries for the delivery of 'soft infrastructure' and fast-track permitting incentives included in the incentive offer to investors and 2) development of a pilot SEZ;
- any specific provisions for procurement and project preparation for SEZs, including cost sharing agreements, expedited timelines and exemptions from any existing public procurement policies.
- the need for an SEZ Law to enact the institutional and regulatory framework, as discussed in Section 7.4.

An SEZ Policy is not a substitute for an industrial policy. SEZs can be used as a tool for Lesotho to achieve its industrialisation objectives. However, it is only a partial, spatially constrained solution. An SEZ policy should not lose its focus by attempting to set out policy reforms which relate to the national investment climate, such as national business environment reforms, skills development, infrastructure provision outside of the zones, trade or competition policy. It is therefore important that an SEZ Policy is consistent and contributes to the objectives of a national Industrial Policy. Lesotho should therefore, as a matter of urgency, finalise and approve its Industrial Policy, ideally before the SEZ Policy is developed.

7.2.1 SEZ objectives

Recommendation 3. The objective of Lesotho's SEZs should be to maximise investment in high value production.

Recommendation 4. The objective of Lesotho's Industrial Estates should be explicitly stated as maximising employment.

The SEZ policy needs to clearly distinguish how new zones will differ from existing (and future) Industrial Estate. The development of an SEZ regime cannot ignore the existing eight Industrial Parks. These Parks benefit from subsidised rental rates. There is a risk that a poorly designed SEZ regime would be unable to compete with these subsidies. Whilst some degree of quality competition to attract investors is desirable, this should not trigger a race to the bottom, with the two models seeking to attract investors on the basis of ever greater (publicly funded) subsidies. The offer of each model should therefore be distinct and tailored towards different market segmentations.

The current Industrial Estates model, with subsidised rental rates, is better suited for low value, labour intensive production. Rental subsidies favour businesses with lower capital expenditure and higher numbers of employees. SEZs should therefore differentiate themselves from Industrial Estates by seeking to attract higher value investment, with greater levels capital expenditure and more productive employment. This should be the explicit target of SEZs in Lesotho, reflected in the policy, the implementation strategy and the package of incentives offered. The objectives of Industrial Estates should also be made explicit to provide investors with a clear signal of which model will work better for their business model. It is recommended that the objective of Industrial Estates is to maximise employment. This is distinct from the SEZ objective and aligns with the current incentives provided.

The indirect benefits will be an improved trade balance, economic diversification, the diffusion of knowledge and technology, higher levels of productivity and employment, and industrial-led growth. An explicit objective of the zones should also be to encourage greater linkages between multinational and domestic businesses.

7.2.2 Support to national economic strategy

Recommendation 5: The SEZ Policy should indicate priority sectors in manufacturing, but implementation should remain flexible and responsive to demand, including in the service sector.

Recommendation 6: Risk assessments should be undertaken to understand the impact of permitting investments in different sectors from locating within the SEZs.

Recommendation 7: SEZs should not be used as the primary tool for regional economic rebalancing.

Zones can also support the development of Lesotho's priority sectors. Lesotho's National Development Strategy highlights several priority sectors, including agriculture and manufacturing, which can benefit from the incentives typically offered by SEZs. However, SEZ can also support a wider range of sectors, including in the service sector, and the future development and implementation of SEZs should not preclude such opportunities.

SEZs need to be aligned with other national efforts to maximise their effectiveness as a tool for sectoral development in Lesotho. Without careful planning zones can often undermine or duplicate economy-wide programmes, leading to unnecessary costs for the government. Any SEZ strategy should seek to align with Lesotho's National Industrial Strategy and Lesotho's National Spatial Strategy. It is therefore important that the implementation of an SEZ regime in Lesotho has widespread government buy in and relevant ministries are consulted in the design and implementation. Although SEZs can infer an advantage to a specific region, the SEZ regime should focus on national economic objectives, rather than as the primary tool for rebalancing regional economic performance. As discussed in section 4, SEZs should reflect, rather than create, the potential for sub-national economic clusters.

The SEZ policy should encourage integration of local firms and inputs. As a strategy to diversify Lesotho's economic production, SEZs may attract 'first-of-a-kind' industries, which will be reliant on imports from abroad in their initial supply chains, though these inputs can be supplemented by local production as it develops. Local content requirements can be a significant barrier to trade[30] and should be avoided to maintain a competitive offer to international investors.

SEZs need to be supported by national policy efforts, with a focus on improving the competitiveness of the agricultural supply chain. As section 2 highlights, many of the challenges facing Lesotho's priority sectors cannot be solved through SEZs alone. For example, the creation of agricultural supply chains requires increased access to finance and better infrastructure. The existence of high quality and cost competitive factors of production in the economy, such as agricultural feedstocks and skilled labour, is an essential ingredient to the value proposition of Lesotho's SEZs which target agro-processing.

In the short term, SEZs should focus on manufacturing subsectors. The SWOT analysis confirms previous work, which indicates significant opportunities is selected manufacturing subsectors. Manufacturing sectors can have significant positive impacts on jobs, exports, and facilitate the diffusion of technology and technical skills. The manufacturing subsectors are also a priority of the Government, ensuring consistency of zone objectives align with broader, national objectives.

The national SEZ regime should not be overly prescriptive in the investments they support. Although the SWOT analysis identifies a number of priority subsectors, SEZ policy, law, strategy, design and implementation should remain responsive to demand. Government should therefore be hesitant to preclude activities.

Individual SEZs should cater towards specific sectors and subsectors. Notwithstanding the need for a flexible and adaptive policy framework at the national level, there are significant advantages of agglomeration which can be achieved when individual zones are designed to meet the needs of specific sectors and subsectors. These benefits can include economies of scale in targeted investment attraction, infrastructure, shared business services (such as basic processing, packaging, logistics and quality assurance), and common supply chains.

In the longer term, SEZs which cater towards business services should be considered. Although service sectors were not explicitly considered as part of this research, there is both evidence of successful service sector SEZs in Africa and internationally, and nascent signs of potential for business services in Lesotho. It is important that the national SEZ Law, and the future development and roll out of SEZs, remain open to the prospect of service sector SEZs.

Certain economic activities may not be suitable for SEZs, and risk assessments should be undertaken at the sector level to determine which investments are most suitable for SEZs. International evidence shows that the investment incentives typically offered by SEZs may not be suitable for investment which seeks to exploit

[30] Research has found local content requirements to have negative impacts on exports from both the specific sector they pertain to as well as the broader economy (Stone, Messent, & Flaig, 2015).

natural resources. Mining activities, for example, should not be promoted by SEZs (although processing of mined products may be). Assessments should be made for investments to understand the risks associated with their location within SEZs. These assessments should consider the impact on competition, the risks of profit shifting, the additionality of the incentives offered in securing investment and the potential for displacement, deadweight losses and forgone government revenues. Such assessments should reflect the incentive packages offered. Particular attention should be given to the retail sector, financial sector and tourism sector.

Applications for an SEZ licence should specify which activities will be fast tracked on the zone, with risk assessments undertaken when SEZ applicants or individual investors seek approval low priority sectors. The SEZ Policy and standard licence terms should make clear that certain activities will be fast tracked. A high level and permissive approach should be adopted, for example automatically fast-tracking all activities covered by the industrial licensing regime, subject to meeting national requirements for issuance of an industrial licence, which may be relaxed for SEZ investors. This should not be confused with a list of positive permitted activities – a negative list will be used to identify activities which are not permitted on SEZs, such as mining. Rather it is to provide reassurance to developers that core activities in their business model, for example in the service sector, will not be subsequently blocked. Where individual investments fall outside of the fast-tracked list (but are not precluded), investments should be risk assessed on a case by basis under a clear and transparent framework.

Risk assessments may be carried out either:

1. at the SEZ application stage, in which case fast-tracked activities are added to individual SEZ licences, with licences guaranteed to individual investors who meet standard national requirements (or streamlined SEZ requirements where dispensations are secured through delegated responsibility or service level agreements); or

2. on an investment-by-investment basis, where individual investors operate outside of the fast-tracked activities identified in the licence, in which case a risk assessment must be undertaken in addition to meeting national requirements for a licence to operate in their sector.

Box 13 Example of risk assessments and fast-tracked activities

- An SEZ developer submits an application to the SEZ Authority to develop an advanced manufacturing and research and development SEZ
- Manufacturing activities are a priority established in the SEZ Policy and fast-tracked in the standard SEZ licence. Individual investors in the manufacturing sector still require an industrial licence. The SEZ Authority has delegated responsibility for issuing these, subject to meeting the national requirements for an industrial licence. Some of these may be relaxed, for example the fees may be waivered. There are no additional SEZ requirements for an industrial licence beyond the standard, national criteria.
- Research and development and digital are central to the SEZ developer's business plan and the developer needs a degree of certainty that such activities will be permissible in the SEZ, however these are not fast-tracked in the standard licence. The SEZ Authority undertakes a risk assessment and concludes that research, education and training services do not represent threats to competition and are added to the fast-tracked activities on the licence. Investors must still have the necessary national licence, which are issued by the relevant ministries under a service level agreement with the SEZ Authority.
- A call centre wishes to set up in the zone. It will service regional (SACU) markets. This is not on the SEZ licence fast-tracked activity list. A rapid risk assessment is undertaken by the SEZ Authority and no risks to domestic competition are identified. The investment involves significant capital expenditure (meeting the SEZ objectives) and needs the SEZ benefits to be viable (no-deadweight). The investment meets the criteria for a trade licence, and is approved by the Ministry of Trade.
- A supermarket wishes to set up in the SEZ. A risk assessment is undertaken by the SEZ Authority which identifies a high risk to domestic competition. The supermarket is not permitted on the SEZ.
- The SEZ Policy states that mining activities shall not be permitted on SEZs.

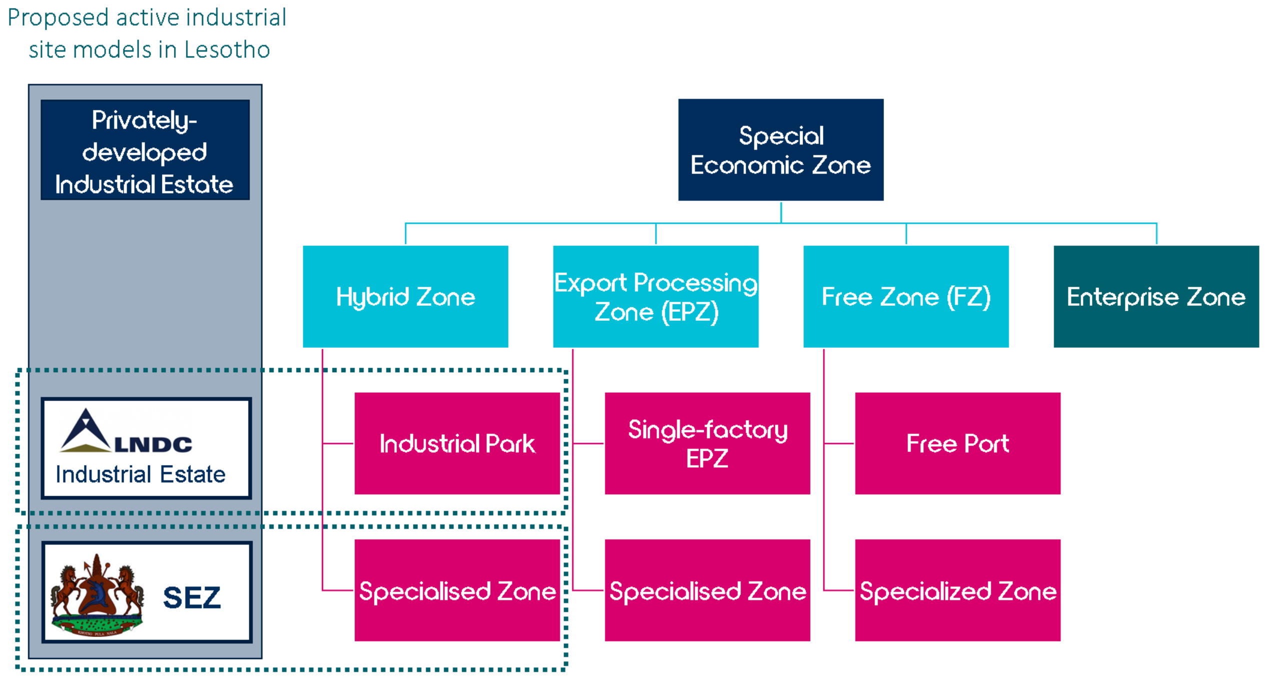
7.2.3 Typology

Recommendation 8. Lesotho's SEZ strategy should be structured around the development of hybrid zones that are flexible to align with investor demand within the context of relevant policies.

Recommendation 9. Eligible investors should be free to locate within an SEZ or Industrial Estate.

Given the objective of developing industrial clusters, a Hybrid SEZ regime is recommended in Lesotho. A Hybrid SEZ approach ensures that the regime is designed on such a way so as to facilitate both exports and supply into the domestic economy. Given the relatively limited industrial base in Lesotho, and the desire for diversification, this model is most appropriate.

Figure 19 Proposed industrial site models in Lesotho



Source: Vivid Economics

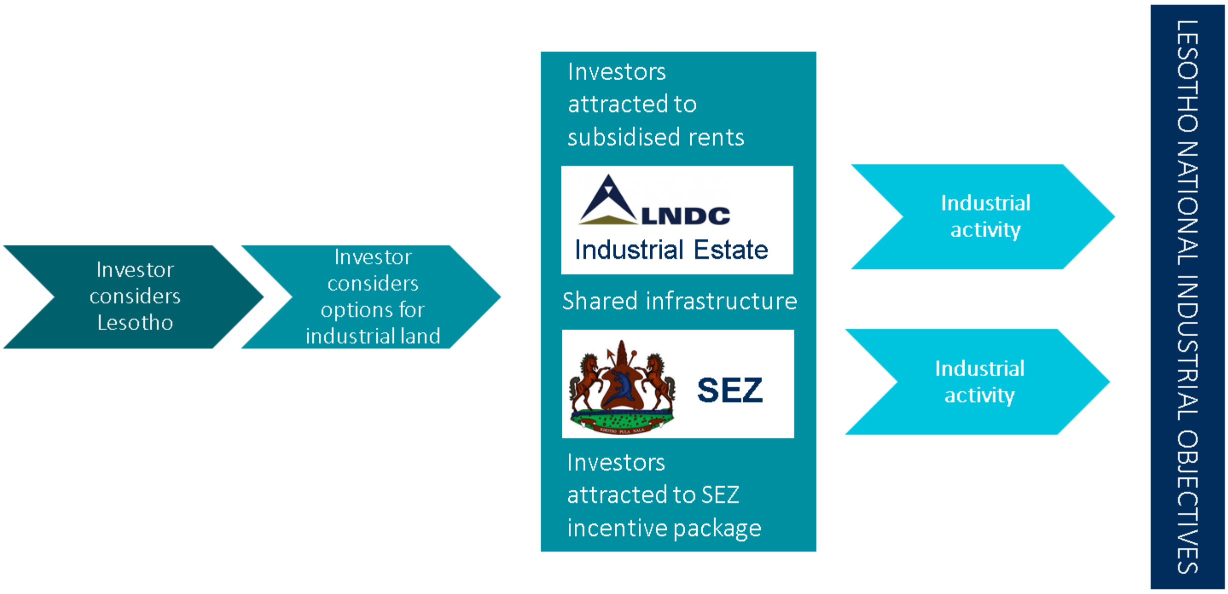
The specialisation and focus of Lesotho's SEZs should be considered at three levels:

- policy – the largely unrestricted national designation of Hybrid SEZ status (as determined in an SEZ Act);
- strategy – the approach adopted in terms of the geographic and industrial sector focus placed on zones in the provision of incentives and government support (as determined by national industrial policy); and,
- operation – the demand-driven zone-level investment promotion and marketing activities undertaken by an SEZ developer/operator (autonomous within limited LNDC national investment promotion guidelines, updated regularly based on market appetite).

It is not necessary for SEZs to have specialisation designated at the policy level, but the option of developing a Specialised Hybrid Zone ought to be considered in future on a case by case basis, based on strategic and operational demands. The specialisation of SEZs can be focused by sector, activity, investor or even geography. In the case of Lesotho this may include zones specifically tailored to businesses focused on the domestic and regional market, or for example, towards medium-sized businesses. In this case, the zone should not be restrictive, but instead targeted in its outreach activities.

An SEZ policy will co-exist with existing and expanded LNDC industrial estates. This means that clear mechanisms will be required to determine the appropriate model for individual investors. While it is possible to develop 'positive or negative' lists which predetermine whether sectors, or individual investors, are guided towards industrial estates or SEZs, international best practice suggests that this is not a desired option. Sectoral lists are generally inflexible and are not responsive to investor needs or demands – this often means that investors are offered suboptimum sites for their businesses. Instead, it is recommended that a supply-side approach is developed whereby two discrete industrial site offers remain available to investors in Lesotho. The clarity provided by publishing distinct (and separate) incentive offers available in each type of industrial site will enable investors to make sound economic choices based on their needs and the relative competitiveness of each offer to their business. This can be considered as part of a decision tree based on economic outcomes and investor expectations.

Figure 20 Investor decision tree



Source: Vivid Economics

Lesotho's approach to SEZs should be flexible, allowing for alignment with national industrial development policy and responsive to investor demand. It is recommended that developers and operators of SEZs should also have some autonomy in the marketing and promotion of their zones, within any constraints as set by national policy or LNDC investment promotion programmes. It is important, therefore, not to restrict the activities that are possible within the zones, but instead allow developers to be responsive and investor-led in their marketing and incentive promotion.

Lesotho's National Industrial Policy should explicitly recognise the parallel system created by the coexistence of industrial estates and SEZs. The Government's industrial policy, current under development, should be transparent in 1) identifying that both industrial estates and SEZs will be supported by the Government and made available to investors, 2) establishing institutional relationships to coordinate between the two schemes and create a policy environment that supports both as tools for investment and 3) incorporate both into Lesotho's marketing materials and engagement with potential investors.

7.2.4 Geography, size and phasing of SEZs

Recommendation 10. SEZ development should be reflected in the National Spatial Strategy where there is investor demand for clustering and agglomeration.

Recommendation 11. Zones should be developed through a phased approach to allow room for growth, aligned with National Spatial Strategy timelines, including a pilot where there are credible development models in place (e.g. Mafeteng).

Recommendation 12. Learning and evaluation activities should be purposefully designed for both 1) pilot phase and 2) in regular intervals, such as the conclusion of a five-year policy.

Given the capital intensity and development timelines of typical tenants in SEZs across global experience, rapid development of a large number of SEZs spread across Lesotho is not recommended. The development of successful SEZs requires significant investment in infrastructure and investor facilitation. The proper development of a small number of regionally competitive SEZs matched to investor demand will be a more successful strategy than a large number of government-driven sites. Considerations, such as access to input markets, transport infrastructure and export facilities, are all critical in considering SEZ sites, though over the long-term these can be developed specifically for any site.

Geography

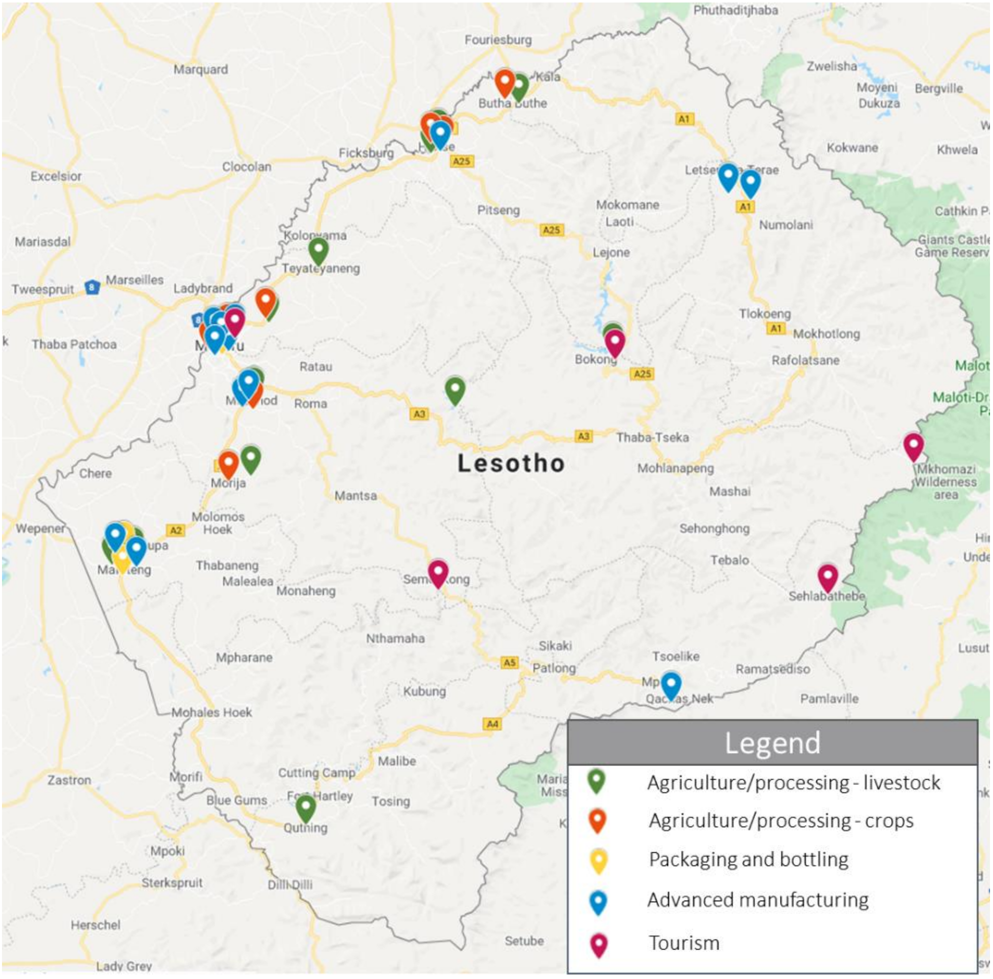
The ongoing development of a National Spatial Strategy provides an opportunity to encapsulate SEZ development in the government's mid-term plans. The Ministry of Local Government is initiating a process to develop a National Spatial Strategy for Lesotho, expected to be developed over the course of 2020.[31] It is expected that this policy will designate the pace and distribution of different types of development in Lesotho, including industrial areas. SEZ stakeholders, including MTI and LNDC should be included in this process and provide inputs in line with the Government's SEZ strategy to be reflected in the National Spatial Strategy.

Figure 21 shows a mapping of opportunities to develop regional clusters, based on existing investments and identified opportunities. These opportunities are drawn from the *2018/19 2022/23 Lesotho Economic Roadmap* (Government of Lesotho, 2019b); investment pipeline data shared by LNDC; and the terms of reference for an ongoing UN World Tourism Organisation study on potential tourism resort locations.[32]

[31] Based on consultant interview with Office of the Commissioner of Lands staff 07/09/2019

[32] https://www.afdb.org/fileadmin/uploads/afdb/Documents/Procurement/Project-related-Procurement/EOI_%E2%80%93_Lesotho_-_Feasibility_Studies_of_Potential_Projects_in_the_Tourism_Sector_to_Attract_Investment_-_Economic_Diversification_Support_Project.pdf

Figure 21 Investment opportunities in Lesotho by sector and location



Source: Vivid Economics using Google Maps and data provided by Lesotho Economic Labs, LNDC and the UN World Tourism Organization

The regional distribution in Figure 21 shows a concentration of opportunities in areas of higher population and existing activity, primarily along the country's northern border with South Africa. This distribution suggests benefits from SEZs drawn from economic clustering are mostly likely in the following locations, which currently have at least three identified investment opportunities:

- Maseru and the greater Maseru area;
- the Moshoesjoe I International Airport area;
- Mafeteng and the surrounding region; and,
- Hlotse.

These four sites have a concentration of investment opportunities, suggesting they may be well-suited for SEZs that allow for clustering, including through shared inputs and infrastructure for a variety of activities.

Additional areas with multiple investment opportunities include Buta Buthe, Berea, Letseng, and Katse. These sites may be considered if regional distribution and development is a key objective specifically prioritised in the government's SEZ policy.

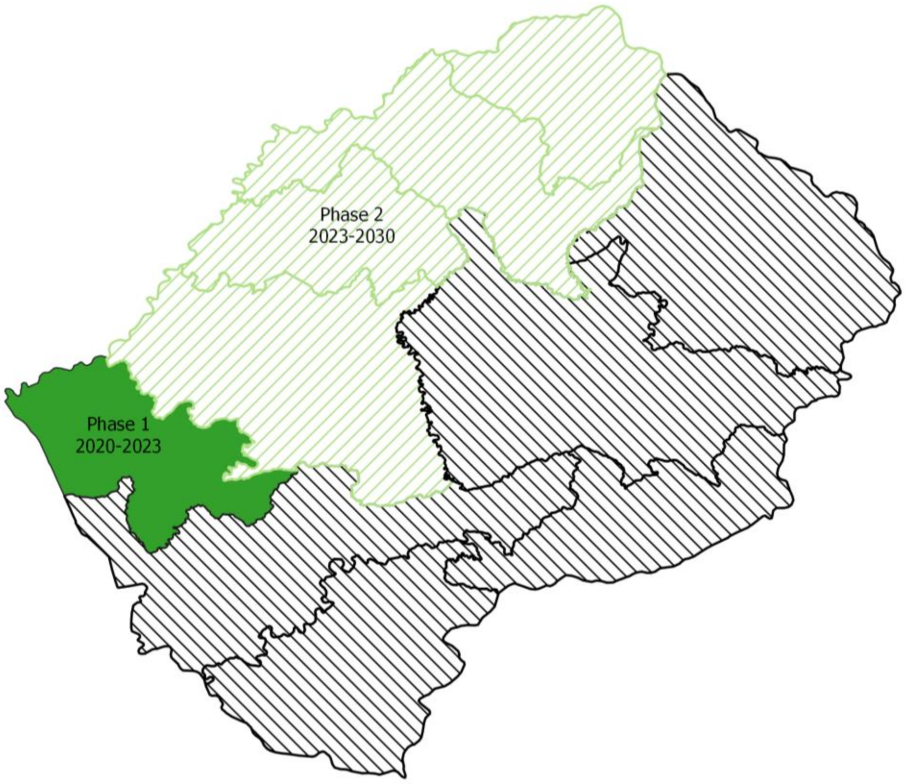
Phasing

Economic zones are complex developments that must be given time to achieve their objectives. Mature SEZs around the world continue to develop incrementally over 30 to 40 years. Development profiles will vary by zone, but often substantial demand will follow 'anchor' tenants to build out substantial districts within an SEZ. To account for these dynamics in a completely greenfield system, the designation of SEZs should follow a phased, market-led approach:

- before developing additional zones, SEZs ought to be piloted in existing or planned developments. A pilot zone based on projects currently being delivered will allow for more efficient spending of public funds to support credible private sector interest. Limiting the initial roll out to a small numbers of pilots will also focus government capacity to consider the policy and regulatory decisions required for a stable SEZ regime, which would be increasingly complicated by the simultaneous development of multiple zones. The proposed Tau Tsehla development in Mafeteng, for example, and a maximum of two other sites, could be included in a pilot phase, subject to the recommended development models described in section 6;
- second, the designation of additional areas in different locations as SEZs should be delayed until this pilot has had time to develop, for example until the end of the current National Development Plan or the forthcoming National Spatial Strategy. A thorough study of the effectiveness of SEZ policy and support should be conducted to identify learnings for the next stage of zone development;
- future phases of SEZ roll-out should consider opportunities in other regions of the country as outlined in section 7.2.4; and,
- finally, phasing of growth within specific zones should be encouraged to allow for organic development of industrial clusters and linkages to SMEs in line with national development plan objectives.

The rate of development should reflect investor demand and allow for evaluation and learning from the pilot zone. As shown in Figure 22, candidate sites appear most likely in Lesotho's northern districts. The development timeline for any additional zones should allow for updates to the national SEZ regime to reflect both learnings from the pilot zone and the specific needs of newly targeted zones (e.g. in Berea).

Figure 22 Proposed phasing for developing SEZs in Lesotho



Source: Vivid Economics

A complete evaluation of lessons learned from the pilot SEZs is necessary for an effective scale up of SEZs. The structure, timeline, objectives and methodology of the evaluation should be designed at the same time as the initial SEZ strategy is developed and properly resourced to capture lessons throughout the duration of the pilot. Information required at the start of the pilot may include local employment, economic activity and exports from the Mafeteng region. Mid-term and final evaluations should be used to assess the impacts of the zone on these same indicators and provide a quantification of the economic benefits associated with the zone against its costs in both direct support and foregone public revenues. The evaluation framework for the National Industrial Policy currently being developed[33] may serve as a good model for this exercise.

To achieve larger payoffs in the medium-term, the SEZ regime must include a phased approach to within-zone development. Successful zones continue to grow and develop throughout their lifetime and both incentives and policies for SEZs in Lesotho should reflect an incremental and continuous development path for the pilot and any subsequent zones. This will include continued support of zone tenants and inclusion of existing zones in national investment promotion efforts.

7.2.5 Regional integration in SEZ strategy

Recommendation 13. Formal relationships should be developed with South Africa's SEZ programme, allowing partnerships with key zones in South Africa and those in Lesotho, allowing for facilitated inter-zone trade flows.

It is important that consideration is given to both the competition for investment posed by regional competitors and the possibility of regional integration for Lesotho SEZs. Southern Africa currently has a number of Special Economic Zones which offer competitive incentives to investors interested in the region.

[33] As set out by EQuIP for the Ministry of Trade and Industry in the 'EQuIP Industrial Policy Design Workplan'

SACU countries in particular are both similarly constrained and united by a common external tariff which presents opportunities for cross-border cooperation on trade-oriented activities in the region.

There is a potential for a race to the bottom as zones across southern Africa offer increasingly competitive offers to investors, there has been a growing international trend for zone partnerships. In this context, it will be important to identify those regional SEZs with the most potential to enhance Lesotho's offer, in terms of both focus value chains and logistics. The zones that present the most obvious, and immediate, opportunities for partnership with Lesotho are located in South Africa and include:

- Coega, Eastern Cape
- East London IDZ, Eastern Cape; and,
- Dube TradePort SEZ, KwaZulu Natal.

These South African zones already benefit from institutional collaboration between themselves (especially the two located in Eastern Cape Province) – a model which could be extended to trade with zones in Lesotho. The upside to such collaboration is two-fold: 1). improved customs and technological collaboration across shared supply and value chains, and 2). greater efficiency in trade and logistics.

Given the potential sector focus of the proposed Lesotho zones, and the significant cross-border flows in feedstock and final goods with South Africa, there is a great deal of complementarity with the activities in the three South African SEZs. Coega has attracted investment in the agro-processing, automotive, aquaculture, energy, metals logistics and business process services sectors. East London focuses on automotive, agro-processing and aquaculture, while Dube attracts manufacturing and value-addition primarily for automotive, electronics and fashion garments. The automotive and agro-processing value chains are of particular interest. Such partnerships are "win-win" for zones, offering investors multiple locations across the value chain, with simplified processes for goods movements between zones. The nature of such relationships is often determined as part of a zone's incentive offering.

7.3 Incentive offering

The current incentive offering to foreign investors is centred on the provision of factory shells leased to firms at significantly discounted rents. As discussed in 2.2.2, this model does not appear to financially sustainable or aligned with Lesotho's economic diversification objectives. To model the impacts of different fiscal and financial incentives commonly offered to SEZ investors globally, a simple cash flow model was developed for manufacturing firms in Lesotho. This model also allows for comparison of bundles of incentives to the current offer of subsidised rents in Lesotho's industrial estates. Box 14 sets out high level assumptions for this modelling approach while results are reflected in recommended incentives discussed in sections 7.3.1 and 7.3.2.

Box 14 Assumptions made in developing an incentives cash flow model for Lesotho

- Firm level accounts were developed using data for the textiles industry in Lesotho contained in the a 2014 IFPRI Social Accounting Matrix for Lesotho.[34] Textiles firms were used as a proxy for all industrial estate (and potential SEZ) tenants given that 72% of exports were from the textiles sector and all textiles firms are assumed to operate in an industrial estate.
- Capital expenditure for each firm was calculated using global average investment per square meter for textile firms. Data was drawn from FT fDiMarkets database;
- Property parcel size was estimated for an average industrial estate tenant using data from BuroHappold (2014); and,
- Therefore the full set of modelled impacts are given for the portfolio of textile companies operating in Lesotho's industrial estates as of 2015. They are therefore unlikely to be exactly representative of tenants in a pilot SEZ but provide a rough approximation of the relative impacts of different incentives, including subsidised rents for a generalised set of foreign investors.

7.3.1 Fiscal incentives

Recommendation 14. Fiscal incentives should be introduced to lower the effective tax rate in SEZs and encourage investment that raises productivity.

Recommendation 15. VAT and customs duties should be suspended on goods sold into or within the zone.

Corporation tax rates

Headline tax rates in Lesotho are low in the region, but fiscal incentives can be used to bring the effective rate down to an internationally competitive rate. Although headline corporate tax rates are competitive in Lesotho compared to the rest of SACU, but that internationally more attractive incentives are on offer. SEZs in Lesotho also need to compete with below-market / break-even rental rates available in Industrial Estates. It is, therefore, recommended that Lesotho introduces significant tax allowances that reduce the effective rate of tax on investments for a time bound period. Reducing the effective rate of tax can be achieved through two approaches:

- Reducing the headline rate of tax; and,
- Providing enhanced allowances or accelerated depreciation to create a larger gap between the headline and effective rate.

Of these two approaches, it is recommended that Lesotho provides enhanced allowances or accelerated depreciation to create a larger gap between headline and effective tax rates for the following reasons:

- reducing headline tax rates provides the biggest benefits to businesses that are the most profitable. This can create serious deadweight costs (i.e. a large proportion of benefits accrues to businesses which would be commercially viable without the incentives). This can create distortionary behaviour (e.g. profit shifting) and are beneficial to 'footloose' investors that do not make significant investments on-the-ground; and,
- providing enhanced allowances or depreciation encourages desired behaviour. Incentives can be targeted to the objectives of the zone. For example, if the objective is to maximise FDI, then allowances can be given based on initial investment. If the ambition is to create jobs, then wages can be given an

[34] SAM contains 2007 economic data

enhanced allowance. Businesses with higher cost bases tend benefit more, but the most profitable businesses still pay tax.

It is recommended that accelerated depreciation (of 100% of capital expenditure) for buildings and machinery is permitted.

In addition to these fiscal incentives, further support can be provided to productive expenditure, such as investments in training, R&D and machinery through direct financial support, as discussed in Section 7.3.3 below.

VAT and Customs Duties

Suspending VAT and duty payments to companies operating inside the zone can confer a significant cash advantage. Suspension, rather than reimbursement, can be an optimal tax arrangement where the costs of capital to the private sector are higher than to the public sector (the time value of money is higher for the private sector) and can support cash flow.

It is recommended that:

- domestic goods and services sold into the zone are deemed exports, are VAT exempt and allow duty drawback;
- machinery and capital equipment imported into the zone are duty and VAT exempt;
- value addition within SEZs and local inputs not to be counted in valuation for tariff purposes
- goods and services sold to another business located within the zone are VAT exempt; and,
- VAT is applied to goods and services sold from the zone into the rest of Lesotho and SACU.[35]

It is recommended that consideration is given to the following:

- Goods and services imported into the zone are duty exempt, duties are applicable to goods imported once they enter the domestic or SACU market. This would require a customs-controlled area within the zone (or the zone to be declared a special customs area), and require customs checks on goods exiting the zone, and require a service level agreement with Lesotho Revenue Authority and on-site presence.

7.3.2 Financial incentives

Recommendation 16. Lesotho should engage with international finance institutions to create a concessional finance facility for SEZ investments.

Recommendation 17. Lesotho should create an SEZ facility which contributes towards the costs of capital expenditure on technology, machinery and equipment, training, and research and development.

Financial incentives can help to close the gap between Lesotho's SEZs, and Industrial Parks and competitor countries. As discussed above, the rental subsidies to Industrial Parks represent a significant but unsustainable incentive to investors which can significantly increase the rate of return, and, therefore, the incentive to invest. This gap can be partially closed with a strong combination of fiscal incentives (discussed in section 7.3.1 above) and hard and soft infrastructure (discussed in section 7.3.3 and 7.3.4 below). However, if a gap remains between the expected rates of return in Lesotho's SEZs and those in Industrial Parks or competitor countries, financial incentives can play a significant role.

[35] Temporary duty/excise/VAT-free admission into domestic/national Customs Territory, for repair and value addition, should be permitted

Financial incentives supporting initial investments

It is recommended that the Government of Lesotho begins engagement with multilateral and bilateral development organisations about the potential for a concessional finance facility to support SEZ investments in Lesotho. The Government of Lesotho does not have the finances to provide a concessional finance facility of the scale required to significantly affect the costs of capital of large investments. Potential funders include the IFC (World Bank), African Development Bank, and the Private Infrastructure Development Corporation (and its subsidiaries Guarantco and InfraCo). These negotiations should build on and go beyond current plans to expand LNDC's Partial Credit Guarantee Scheme.

Financial incentives supporting productive activity

To meet SEZ objectives of attracting higher quality FDI, zones can also offer financial incentives targeted towards the needs of higher value-add industries. The subsidised rental rates in Lesotho are most beneficial to investments that have a low value-add per square meter. They encourage low value, labour intensive investments with low levels of capital investment, such cut-make-trim processing in the textiles sector. These investments are often 'footloose' and do not contribute to long term increases in productivity. Better targeted financial incentives provide an opportunity to promote higher value activities, investments in productivity and innovation. They also provide an opportunity to differentiate SEZs in Lesotho from the existing Industrial Estates.

Financial incentives should focus on activity which raises productivity, including investment in specific types of capital expenditure, such as technology, machinery and equipment, training and research and development. Such incentives would require Lesotho to establish a financing facility that made partial contributions to these costs. This is preferred over a fiscal approach, given the low corporate income tax rate on manufacturing activities, and would help to transfer some of the risk of such investments to the state. Training costs are the most feasible costs to subsidise and government could offer a large contribution (e.g. 50%). R&D costs are more complex to validate; but are also likely to be affordable. Capital expenditure on technology, machinery and equipment are relatively straightforward to identify, but may be high cost, and the Government contribution should be limited (to e.g. 10%). Capital expenditure on items that do not create dynamic opportunities for productivity growth (such as construction and transport) should not be eligible for grants. Financial incentives can also be used to support the development of domestic linkages through supply chain upgrades.

Establishing an Infrastructure Fund

Industrial investment in zones, and across the country, will be closely correlated with the provision of appropriate infrastructure. In addition to providing support in the development of SEZ related on-site infrastructure, a dedicated Infrastructure Fund will also be able to coordinate investment in off-site infrastructure, such as roads and transmission lines. This commitment would build on the delivery framework already in place in Lesotho. For example, Lesotho's Ministry of Public Works is committed to the delivery of road infrastructure to the edge of private sector urban development for city extensions.

While facilitating investment in zones, an Infrastructure Fund would also enable the Government of Lesotho to meet wider infrastructure financing gaps. Seed capital for an Infrastructure Fund may be derived from various sources: including the Government of Lesotho's main budget, an SEZ finance facility, development value capture contributions; match-funding from aid and donor institutions. A designated Infrastructure Fund would then be able to plan and facilitate the required investment. This Fund would be able to deliver infrastructure in multiple ways:

- direct public funding of infrastructure projects;
- leveraging private finance;

- participation in Public-Private Partnerships through:
  - ◊ co-financing agreements with the private sector and parastatals; and,
  - ◊ risk sharing or guarantee provision.

As well as funding and participating in financial mechanisms to deliver infrastructure, a dedicated Infrastructure Fund can also support project preparation and planning. This could take the form of a Project Preparation Facility within the Fund, designed to improve project preparation, working to increase the number of viable, well-prepared, investment-ready infrastructure projects. There are existing case studies and models in Southern Africa for these funds, including the Project Preparation Facilities Network (PPFN) – an AfDB backed network of funding facilities and institutions dedicated to developing sustainable infrastructure in Africa. The PPFN advocates for financial resources for infrastructure project preparation and undertakes information and data sharing about projects, case studies and best practice in governance

7.3.3 Hard infrastructure

Recommendation 18. Ensure internationally competitive levels of utility and infrastructure service to new industrial land sites (off-site and on-site).

Recommendation 19. Transition from the subsidised support of rents to funding enhanced shared infrastructure across LNDC portfolio.

Recommendation 20. Enhance border infrastructure enabling easier cross-border transit of goods and feedstock associated with the zones.

Recommendation 21. Consider land reforms enabling wholly private ownership of land (or long-term protected land leases) for SEZ investors and developers.

The provision of hard infrastructure to industrial sites is often considered one of the most basic incentives provided within SEZ regimes. SEZs have an important role in providing hard infrastructure given their high fixed costs and the potential inefficiency of multiple infrastructure providers. This presents an opportunity for Lesotho's SEZ regime to rectify a (perceived) market or service failure to ensure the zones are competitive. This will include ensuring minimum service levels, and provision, for basic infrastructure such as access roads and power and water to site, wastewater and solid waste management services, and potentially telecommunications. Provisions should allow private electricity generation, water distribution, waste management, mobile telephony services.

Transport

Given the trade orientation of activities in SEZs, access to markets are a key requirement of foreign investors. Transport links including quality roads and easy access to regional air and rail links should be included in strategic planning around areas considered for SEZs. Border crossings proximal to SEZs must allow for the efficient and secure transport of goods from nearby SEZs to regional markets. For example, the border crossing closest to Mafeteng does not operate 24 hours a day and often has significant wait times for cargo looking to enter South Africa.[36] The upgrading and operating of these border stations should be prioritised to facilitate trade of SEZ outputs to regional markets.

Water

[36] Based on stakeholder interviews with consultant team in September 2019

It is critical that adequate water supplies, and wastewater facilities are considered when developing SEZ sites. SEZs focussed on agro-processing activities will be especially sensitive to the availability of water to support irrigation and processing.

It is recommended that provisions are made for:

- a service level agreement for guaranteed water supply with WASCO at agreed prices;
- a service level agreement for prioritised connections to the water network for the SEZ and individual investments;
- the SEZ has the option (but is not obliged) to install wastewater treatment facilities onsite if required; and,
- technical, safety and environmental regulation of any generation, storage or distribution assets remain the responsibility of LEWA.

Energy

Ensuring reliable electricity supply is critical for business. It is vital that the SEZ receives a guarantee of supply from the Lesotho Electricity Company. In addition, it may be desirable for the SEZ to have some ability to install and operate:

- its own distribution network (mini-grid);
- distributed renewable generation; and,
- energy storage.

It remains unclear to what extent the current legal and regulatory framework facilitates these in general. Certain aspects of the legal and policy framework have yet to be passed by parliament, although draft documents, such as the purchase-power-agreement, have been published by LEWA.

It is recommended that provisions are made for:

- a service level agreement for guaranteed electricity supply with LEC (e.g. which explicitly identifies SEZ operations as priority in terms of exemptions from load-shedding and other potential interruptions in electricity supply);
- a service level agreement for prioritised connections to the grid for the SEZ and individual investments (where the SEZ does not elect to establish its own distribution network);
- the SEZ has the option (but is not obliged) to establish its own distribution network (mini-grid);
- the SEZ has the option (but is not obliged) install energy storage and distributed generation. A feed-in tariff to the main grid should be agreed;
- technical, safety and environmental regulation of any generation, storage or distribution assets remain the responsibility of LEWA; however; and,
- the SEZ has autonomy to self-supply to businesses within the zone, or to distribute electricity purchased from LEC, at prices determined by the SEZ operator with approval from the SEZ regulator.

Financing Infrastructure

Lesotho's SEZs should consider new ways to finance infrastructure provision within the zones. There are various models of such provision, ranging from independent delivery on behalf of the SEZ operator, through to Service Level Agreements (SLAs) with existing service providers in Lesotho, or participation in an Infrastructure Fund as outlined in section 7.3.2. In all cases, enhanced services will come at a cost, however. LNDC currently operates an effective subsidy of rental rates for investors in its Industrial Parks. Providing enhanced infrastructure for investors in the new SEZ sites presents an opportunity for co-benefits for LNDC tenants where industrial estates, SEZs, and potentially privately developed sites are co-located. In order to maximise the wider impact associated with improved SEZ infrastructure it is recommended that LNDC redirect support from subsidising rents in new industrial estates to funding shared infrastructure across its landholdings. This could be via the proposed Infrastructure Fund. This model would not affect existing tenants, but new investors and new sites. This would allow for a transition to a model whereby LNDC provides support for competition enhancing hard infrastructure, as opposed to direct subsidisation of rents.

Given Lesotho's dependence on the border with South Africa for its international trade flows, the SEZ programme must consider ways in which to facilitate these flows for zones located near border areas. Hard infrastructure interventions may include enhanced access to the border posts, such as roads from the zone with exclusive and/or fenced border access. Given the planned expansion of rail facilities in Lesotho, it may also be appropriate to consider options for bonded rail routes from zone sites to the border. In both cases, these options should be considered on a case-by-case basis but be demand-led and fulfil a request from investors, given the investment and institutional buy-in required. Beyond the border itself, the SEZ programme may also want to consider the potential for enhanced regional transportation links. This may include co-funding or support to road or rail upgrades between the Lesotho state border and the Port of Durban, for example. Other considerations may include enhanced security for Lesotho-registered logistics vehicles travelling through South Africa. These issues will need to be considered in any bilateral SLAs with South Africa.

Finally, to improve the competitive offering of Lesotho's SEZ, land tenure options for zone investors will need to be reviewed. The current structure of land ownership and tenure in Lesotho is complicated, and often perceived as both a barrier to investment and to the expansion of existing operations. While the Land Act of 2010 does allow limited land ownership by foreign nationals (and investors), the land must be in a joint venture with Lesotho nationals (minimum 20% locally owned).[37] Given international norms in this regard, and the importance of long-term tenure to international capital investors, pure private land ownership (or long-term leases) should be permitted, including 100% foreign ownership. Botswana has recently announced similar measures as part of the country's reformed SEZ programme, allowing fixed leaseholds to foreign nationals of 50 years, beyond the pre-existing maximum of 25 years.[38] These incentives will only be fully realised through the development of a robust soft infrastructure offer.

7.3.4 Soft infrastructure

Recommendation 22. A one-stop-shop (extension of OBFC) should be established in each zone to provide a range of business support and regulatory services which are core to the SEZ value proposition.

Recommendation 23. Ensure the provision of business support services, preferably through engaging the private sector in a PPP.

Ease of doing business

Ease of doing business ought to be the core value of any future SEZ programme in Lesotho. Global experience highlights that provision of a business-friendly regulatory regime is often a key determinant of investment location, with most fiscal and financial incentives relatively undistinguishable across zones. Expedited processes for businesses are particularly important in countries which otherwise face delays in their everyday

[37] https://www.export.gov/article?id=Lesotho-protection-of-property-rights
[38] https://www.export.gov/article?id=Botswana-market-opportunities

business operations. Considering the gaps highlighted in Lesotho (see section 5), incentives should specifically aim to create a conducive business environment through a range of regulatory and business support services.

Additional support to SEZ investors should include access to information required to invest and navigate the regulatory landscape once operating in Lesotho. Countries with successful SEZ programmes offer investors clear contact points for government account managers providing information on regulatory developments, linking investors to domestic supply chain businesses and supporting bids for expansion to home offices around the world, including expediting visas for employees. For investors considering entry into the zone, these services provide an essential contact point to answer questions and build a business case for investment. An investor service point should consolidate and repackage existing and zone-specific incentives available to investors, reducing the costs of researching and applying to different schemes. Broadly, support services offered to current or future SEZ tenants should include:

- investment promotion, including attracting tenants to the zone but also attracting further tenants that provide agglomeration and industrial symbiotic benefits to existing tenants (e.g. through provision and reduction in cost of shared infrastructure);
- investment facilitation, including the provision of information to prospective investors upon initial investment into the zone, as well as supporting expansion plans and business cases to corporate headquarters for further investments in Lesotho. These services may also include matching investors to local suppliers and skilled workers as well as other investors that may be able to support a specific supply chain; and,
- investor aftercare services, including providing a regular point of contact for information and enquiries and facilitating investor requests for government services and regulatory incentives as identified in service level agreements with regulatory agencies. A key area of support that may be included in investor aftercare services include Government staff support to investor initiatives to enhance the zone offer. For example, in the proposed Mafeteng SEZ, developers have proposed the development of transport infrastructure (a rail spur and air strip) as well as a joint proposal to international climate finance funds to restore agricultural land around the region.

A 'one-stop shop' for each zone can be key to attracting foreign investors and developers by helping expedite burdensome regulatory process and reducing the costs of daily administration. One-stop-shops are typically viewed as one of the most valuable incentives provided by successful SEZ regimes, through their role in helping to reduce administrative costs faced by zone users. Lesotho's OBFC can help fulfil this role in Lesotho's future SEZs by acting as an on-site provider of regulatory services. Successful onsite support would require: 1) a permanent onsite presence in all SEZs; and 2) SEZ-specific SLAs with line ministries to allow in-zone OBFC representatives to offer an effective and competitive one-stop-shop service to SEZ firms. To deliver the positive returns of one-stop-shops elsewhere, support services should include:

1) <u>streamlining of all administrative processes</u> by acting as the single interface for the processing of all paperwork and regulatory queries. This is currently the remit of OBFC but is only offered in its Maseru offices (with some services provided by district-level Ministry of Trade and Industry offices). SEZs will require dedicated staff onsite able to address investor questions and provide expedited administrative support; and,

2) <u>fast-tracking business regulation</u> relevant to zone users through informal coordination and formal agreements (such as SLAs) with other government ministries. Existing agreements between line ministries and OBFC allow for some simplification and consolidation of administrative processes, but additional incentives specifically available to SEZ tenants should be established through similar channels for the provision of onsite services. Recommended areas for additional SLAs are set out in Table 20.

A full set of potential soft infrastructure incentives are provided in Table 18.

Table 18 Additional soft infrastructure incentives

Theme	Issues to consider
Institutional matters relating to SEZ regulation	• OBFC branches in SEZs and associated MoUs • OBFC services expansion
Land use and infrastructure regulation	• Land banking modalities • Concession agreement framework for SEZs and SEZ infrastructure assets (including for "last-mile" connective infrastructure), including competitive tender procedures • Project and developer qualification conditions and criteria • Standard Developer Agreement content for competed projects on public land • Licensing framework for private developers • Non-expropriation guarantees • Streamlined construction and development control regulation • MoU framework with Land Administration Authority (LAA) and Ministry of Development Planning
Business/activities licensing	• UNCITRAL compliant electronic signature rules • Derogated licensing to OBFC for agro-allied sector
Trade facilitation	• Removal of bonds • Efficient Customs clearance procedures, including privatisation of certain Customs functions under public services concessions, onsite ex-post inventory controls, etc. • Onsite matching, twinning, and local supplier and buyer forward and backward linkages scheme arrangement
Tax administration	• Tax administration modalities (NB: not fiscal incentives) • Use of IFRS and IAS standards for investor accounting • MoU framework with MoF/LRA
Labour regulation	• Permissive and streamlined hiring, negotiated productivity package, and termination norms • Permissive and streamlined expatriate entry norms and procedures
Agricultural sector regulation	• Rules for IPR (including Protected Plant Variety) registrations • Scope for SEZ Authority to issue enhanced SEZ biosafety, food safety, sanitation and agricultural research & development regulations • Preventative and risk-based control procedures that comply with internationally recognized practices such as Good Agriculture Practices (GAP), Good Manufacturing Practices (GMP), Good Hygienic Practices (GHP) and HACCP, ISO 22000 and other relevant ISO standards

Theme	Issues to consider
	• Inter-agency MoUs for onsite presence of: Quality, Product, Process, Standards, and Trade Certification services; Ministry of Labour, Ministry of Agriculture & Food Safety, and recognised specialised technical training institutions / extension services; R&D, patenting, and product commercialization services, in conjunction with recognized universities and/or legal services providers; Quarantine, laboratory services and facilities, and SPS advisors
Commercial disputes resolution	• Alternative dispute resolution procedures, based on arbitration

Source: Locus Economica

Shared services

Beyond regulatory support, provision of shared services can help to maximise the benefits of clustering economic activity in SEZs. The agglomeration of economic activity in SEZs is increasingly attractive to firms when they can benefit from the proximity to supplies and business services. Collocation of multiple steps in a product's supply chain can help to reduce costs for investors and has positive knock-on benefits by helping to attract even more firms to an SEZ with little additional effort.

Given the likely focus of Lesotho's pilot SEZs, specific focus should be given to ensure businesses can access cold storage, packaging and lab testing facilities. Regardless of the sector in which a firm operates there are many services which every investor will wish, such as waste management or logistics services. Each sector will also have unique services that they require and ought to be considered by zone developers. For instance, agro-processing sectors will typically require washing and drying facilities and cold storage. The medical cannabis sector would require a high-quality lab testing service.

It is recommended that these services ought to be provided through PPPs, or, as a last resort, through direct public provision. Though these services can be provided by the private sector, it is likely that private interest in zones will be weak until the demand from zone users is proven. The private sector vacuum ought to be filled through government support, which can ensure access to these services either through:

- joint venture public private partnerships, where the government enters a contractual agreement with a private party to provide a service. The two parties typically create a special purpose vehicle, and allocate themselves differing shares of equity and responsibility over the project lifecycle; and,
- direct public provision of the service, which we would recommend only as a last resort if private sector interest is not available.

7.4 Institutional and regulatory framework

7.4.1 Legal and regulatory framework

Recommendation 24. An SEZ Authority should be established through an SEZ Act.

Recommendation 25. The creation of a favourable business environment in SEZs should be achieved principally through service level agreements with relevant ministries, authorities and parastatals.

Recommendation 26. Prioritise the development of a robust PPP law and policy framework in Lesotho.

Recommendation 27. An interim solution may be to establish an SEZ Unit in the Prime Minister's Office, with service level agreements between responsible Ministries and the LNDC (as a development partner).

SEZ status should be established in law through an SEZ Act. This law should be written to provide a long-term legal framework within which to develop SEZs.

An SEZ Act should establish an SEZ Authority. One of the most critical components of an SEZ Act is to establish the legal entity which would be responsible for assessing and recommending the designation of land for SEZ status, issuing SEZ licences to developers, and entering into service level agreements with ministries, authorities and utility providers. This requires an entity that can negotiate and sign memoranda of understanding and with influence over other public entities which may not see an SEZ as a priority. It is recommended, based on international best practice, that this is a standalone SEZ Authority. The responsibilities and governance arrangements are discussed in Section 7.4.2.

Establishing an SEZ Authority will take time, and interim measures may be required for the successful implementation of a pilot scheme. Potential interim solutions for assigning responsibility for finalising the SEZ Policy, establishing service level agreements, designating land as SEZ status and overseeing the implementation of a pilot SEZ include:

- establishing an SEZ Unit in the Prime Minister's Office to act as an interim authority (similar to the current set up of the OBFC under the MTI).
- Expanding the mandate of the Central Delivery Unit established in the Prime Minister's Office under the Economic Labs programme. This approach benefits from the momentum established under the Economic Labs project and may encounter less resistance than concurrently establishing a separate unit under the PMO. It has the advantage of close coordination with the Investment Climate Reform Committee. It is therefore recommended as a potential interim approach.
- Assigning responsibility to the National Reforms Authority in MDP as part of suggested Economic Reforms. This has the advantage of convening power across ministries, fast-tracking the necessary legislation and coordination with wider policy developed. It is therefore recommended as a potential interim approach.
- Establishing an SEZ Unit under the Ministry of Trade and Industry (equivalent to the OBFC). However, this runs the risk of disputes of ministry mandates and may hamper progress, and therefore is not recommended.
- A cross ministerial task team coordinated by the Government Secretary. However, the lack of a clearly defined legal entity which is able to enter into memoranda of understanding / service level agreements risks creating a weak team that cannot accelerate progress nor enter nor hold other ministries to account and is therefore not recommended.
- LNDC to directly enter into service level agreements as a development partner within a pilot zone. However, this approach risks creating an unsustainable precedent of ad-hoc agreements on a zone-by-zone basis operating outside of a clear regulatory framework and governance structure; and is therefore not recommended.

Box 15 Difference between service level agreements and delegated responsibility

Two principal approaches are utilised to improve SEZ enterprises' regulatory compliance experience, by way of reduction of administrative barriers to investment (including red tape, overlapping government responsibilities and requirements, and time generally spent "running around" amongst various government offices): "delegated responsibility" and "service level agreements". It should be noted out the outset that these two approaches should not be viewed as mutually exclusive alternatives; indeed, in most SEZ programmes, a combination of the two approaches is adopted.

Delegated responsibility or “derogated responsibility” is a regulatory approach whereunder one government entity (in the case of SEZ regimes, this is the government entity with primary responsibility for seeing to the application of the SEZ Act) see the regulatory powers of another formally delegated to it, as a result of which the ordinary regulatory state-of-affaires is “derogated” from. This can be done on either a permanent/legislative basis, through “legislative derogation” under the SEZ Act or through “administrative delegation” under an agreement between the two bodies.

Interagency Service Level Agreements (SLAs) or Memoranda of Understanding (MoUs) is a less radical approached, through which written undertakings are used to articulate areas where ongoing liaison, cooperation and cooperation are required by two different ministries, their roles and responsibilities, and how this is to occur. Under most SLA arrangements, jurisdiction on the matter at hand is in effect “shared”, with both parties having a say but one of the two parties taking on the primary executing responsibility.

Source: Locus Economica

It is recommended that the Act makes minimal changes to existing laws where these can be addressed within the scope of existing legislation. The full range of issues to be considered in preparing this law are set out in section 6.1.3. For each issue, a decision needs to be taken about whether national laws and regulations should apply, where existing laws provide scope to make ‘special arrangements’ for SEZs, where different laws should apply, where the SEZ Authority should be given regulatory responsibility, and where the issue should be addressed through a service level agreement between the SEZ Authority and responsible ministry, authority or parastatal. Examples are provided in Table 19.

Table 19 Recommended areas for Service Level Agreements and Delegated Responsibility

Approach	Examples
SEZ retains national law	Criminal law
SEZ supersedes national law	Allow 100% foreign ownership of land
Existing laws permit special SEZ regime	Minister of Finance can change the tax code for SEZ to allow for enhanced cost recordings and accelerated depreciation
SEZ Law should delegate regulatory responsibility to SEZ Authority	Conditions for business licences
National law retained, but service level agreement ensures effective implementation	Environmental permits and labour standards; utility connections

Source: Vivid Economics; Locus Economica

Whilst international best practice is to delegate significant responsibility to the SEZ Authority, best fit for Lesotho may be to focus on service level agreements. Regulatory delegation allows for SEZ authorities to change regulation rather than simply fast-track it, helping to overcome government inertia. As discussed in **Error! Reference source not found.**, delegation can either be 'hard' (enacted through legislation) or 'soft' (enacted through agreement). However, delegation requires significant capacity at the SEZ Authority to effectively regulate across multiple areas. This creates a significant risk: if capacity to effectively regulate is scarce, delegation of regulatory responsibility aimed at improving the business environment may be counter-productive. It is therefore recommended that Lesotho delegate responsibility only in specific regulatory areas (see Table 20). Specific areas of delegated responsibility should be set out in an SEZ Act. This would allow for the SEZ Authority to provide instant approval of business licensing or create simplified requirements for approval of construction permits, for example.

Table 20 Recommended areas for Service Level Agreements and Delegated Responsibility

Regulatory area / Theme	Preferred SEZ regulatory approach
Title registration	SLA (with the Land Administration Authority)
Master planning and land use	SLA (with T&C Planning Authority, e.g. Ministry of Local Government)
Building, occupancy, internal zoning permits, internal roadworks, health & safety permits, fire clearances	Delegated Responsibility (to SEZ Authority)
Environmental permits	SLA (with the SEZ Authority)

Regulatory area / Theme	Preferred SEZ regulatory approach
Utilities regulation	Either SLA (with utility regulators) or Delegated Responsibility (to SEZ Authority), depending on capacity
Utilities connections	SLA (with utility regulators)
Incorporation	SLA (with Companies Registrar)
SEZ Business Registration and Licensing (with exception of financial services)	Delegated Responsibility (to SEZ Authority)
On-site provision of One-Stop Shop	SLA (with OBFC)
PPP structuring and approval	SLA (with PPP Unit)
Visas, Work and Residency Permits	SLA (with Ministry of Home Affairs)
Social Security	SLA (with Social Security Fund)
Labour inspections	Delegated Responsibility (to SEZ Authority)
Labour dispute resolution	SLA (with Ministry of Labour)
Customs	SLA (with Lesotho Revenue Authority)
Tax policy	SLA (with Ministry of Finance)
Tax administration	SLA (with Lesotho Revenue Authority)
Municipal taxation	SLA (with SEZ Authority)
Foreign exchange regulation (if applicable)	SLA (with Central Bank)
IPR registration	SLA (with of competent IPR bodies)
SPS, quarantine and biosafety control	SLA (with of Ministry of Agriculture and/or Customs Directorate)
Commercial dispute resolution	SLA (with of Courts and Arbitration Centres)
Bilateral relationship (with South Africa)	SLA (with of Ministry of Foreign Affairs and International Relations, South African Department of International Relations and Cooperation, and South African Revenue Service)
Investment promotion, facilitation and aftercare	MOU (with LNDC)

Source: Vivid Economics; Locus Economica

A clear and complete legal framework for public-private partnerships is still in development in Lesotho and must be in place to facilitate effective private sector involvement in the development of the zones. Both processes and minimum acceptable terms for PPP agreements can be specified in a PPP law and provide a more stable framework for future projects, including the development of SEZs.

7.4.2 Institutional responsibilities

Recommendation 28. The SEZ Authority Board should consist of key Ministers, with representation from the private sector, and chaired by either the Prime Minister of Deputy Prime Minister.

Recommendation 29. LNDC's role should focus on the promotion and development of SEZs.

The Board of the SEZ Authority should include key Ministers. SEZs cut across the remits of multiple ministries and it is vital that inter-ministerial coordination and cooperation is ensured, particularly where responsibilities are not legally delegated to the Authority. A review of international best practice suggests that ensuring the Board has senior representation from key ministries; and is chaired by an individual with the authority to resolve inter-ministerial disagreements, is critical. The SEZ Authority Board will benefit from a large degree of autonomy and a broad understanding of the country's national development strategy, helping it to effectively approve SEZ licenses. Through the involvement of multiple agencies, the ministerial committee can also strengthen linkages amongst and between the various stakeholders within the public sector. For instance, promoting consensus and consistency in implementing shared policy objectives and developing effective working relationships with other government agencies. The SEZ board should comprise of all public-sector agencies which are impacted by, or can impact, the development of Lesotho's new SEZ regime. This includes:

- the Deputy Prime Minister (Chair);
- the Ministry of Trade and Industry (Secretary);
- the Ministry of Local Government;
- the Ministry of Development Planning;
- the Ministry of Finance;
- a representative of the organized private sector, from Lesotho's Chamber of Commerce; and,
- possibly the Ministry of Agriculture & Food Safety and Ministry of Labour.

Many of these agencies already meet as members of Lesotho's Investment Climate Reform Committee, which could help to serve as the formal structure for the future SEZ Board.

The SEZ Authority will act as a regulator of SEZs, contracting point for service level agreements, and advisor on SEZ Policy. The SEZ Authority will be responsible for issuing SEZ licences to developers. It should monitor performance of developers and act as a regulator in areas where it has delegated responsibility, as set out in Table 20. It should also advise the Board on SEZ Policy. It is vital that it is sufficiently staffed to execute the functions assigned to it, and should have budgetary independence to do so. The SEZ Authority will be required to fulfil several responsibilities to help ensure that zone development is aligned with SEZ policy and is attractive to investors. These can be broadly translated into:

- Conducting a sensitisation programme on SEZs;
- Coordinating the development of the SEZ policy and law as well as the regulatory and operational framework, promoting consensus and consistency in implementing shared policy objectives, developing effective working relationships with other government agencies
- Developing ToR for consultancies and recruitment of consultants;
- Preparing a workplan and budget for SEZ activities, and mobilising resources for this work and for its own operations;

- Facilitating the rolling out of an initial pilot SEZ; including stimulating public-private partnerships (PPP) to attract investments into proposed SEZs;
- regulation, which will involve reviewing zone licenses and monitoring compliance of activities in zones according to statutory criteria. In this role, the SEZ Authority must have the statutory responsibility for authorising SEZ licenses. It ought to meet approximately once every month; and,
- operation management, which will involve designating SEZ land, conducting prefeasibility studies and facilitating government services in zones to ensure that a competitive investment offering is maintained throughout Lesotho's SEZs. In this role, the SEZ Authority must have authority to expedite government services, such as business licenses or environmental permits, either through service level agreements or laws that designate responsibility to the authority (see Box 16). It must meet several times a month to ensure investor challenges are tackled promptly.

Box 16 Application of Service Level Agreements (SLAs) and Delegated Responsibility in SEZs

Service Level Agreements (SLAs) and Delegated Responsibility models are two, mutually compatible approaches, to increasing the implementation capacity of SEZ agencies. Two principal approaches are utilised to improve SEZ enterprises' regulatory environment, by helping to reduce administrative barriers such as red tape, overlapping government responsibilities, and inefficiency in public agencies:

- **Delegated responsibility** (also known as "derogated responsibility") **is a regulatory approach where one government entity see the regulatory powers of another formally delegated to it**. In the case of SEZ regimes, this is the government entity with primary responsibility for seeing to the application of the SEZ Act. This responsibility can be delegated either a permanent/legislative basis, through "legislative derogation" under the SEZ Act or through "administrative delegation" under an agreement between the two bodies.
- **Interagency Service Level Agreements** (SLAs) (also known as Memoranda of Understanding (MoUs) is where **ongoing liaison, cooperation and cooperation are required by two different ministries.** The roles and responsibilities of each agency, and the requirements of the SLA are can be an administrative agreement decided between the agencies or legislative requirement stated in the SEZ Act. Under most SLA arrangements, jurisdiction on the matter at hand is in effect "shared", with both parties having a say but one of the two parties taking on the primary executing responsibility.

In most SEZ programmes, a combination of the two approaches is adopted.

Source: Locus Economica

In this new institutional model, there ought to be a clear distinction between the role of the SEZ Authority and the zone developer or operator, which can be public or private. Effective SEZ administrations typically structure a clear distinction between the SEZ regulator and developer-operators. This separation avoids conflicts of interest, confusion of goals and responsibilities, and skill gaps which result when entities act as both regulators and developer-operators. This separation also helps to avoid crowing out of private sector's involvement in zone development or operation (see section 6.1). For recommendations on the preferred SEZ development model see section 7.4.3.

LNDC will be responsible for investment promotion to potential SEZ developers and to SEZ tenants; and may act as a public sector developer or development partner. This will involve publicising the comparative advantage of Lesotho's SEZ programme to potential SEZ developers to activities at the zone level. Investment promotion at the zone level is outside of the scope of the Authority and will reside with the individual zone operator. In this role, the SEZ Board ought to promote SEZs alongside ongoing national promotion initiatives and respond to ad-hoc investor interest. LNDC's Property Development and Management Department is experienced in the acquisition and development of land, while LNDC's Investment Promotion department has connections to publicise Lesotho's investment potential. Leveraging the know-how and connections of these LNDC departments can minimise the costs of scaling up SEZs.

Under the proposed institutional set-up, responsibility for the development of the upcoming pilot SEZ will reside with LNDC's Property Development and Management Department. In the operational management role, LNDC's Property Development and Management Department will be essential to facilitating the rolling out of an initial pilot SEZ in Mafeteng. As a first step, it ought to prepare a workplan and budget for the lifecycle of the pilot project. It also must coordinate with the Lesotho's PPP unit to help structure a PPP contract conducive to a private developer and work with interested private developers to prepare a bid for the regulatory arm of the SEZ board to review.

7.4.3 Development model

Recommendation 30. The full spectrum of public, private and PPP SEZs should be permissible.

Recommendation 31. Private sector involvement in the development and operation of zones should be encouraged through a) legal eligibility of private developers in tenders for zone licenses, and b) government incentives to attract private developers through financing of feasibility studies and best practice PPP arrangements.

Lesotho should encourage increased private sector involvement in zone development and operation to help ensure future SEZs are financially sustainable. The research summarised above highlights a key concern of any future SEZ regime in Lesotho is financial sustainability and the limited borrowing funds across government. Given the high upfront costs of developing zones, private sector development of new sites is essential to provide an injection of need capital. Global SEZ best practice highlights that the private development and operation of zones can also bring efficiencies which improve the commercial returns from Lesotho's zones.

Purely private and PPP models for zone development can both have a place in Lesotho's future SEZ regime. Experience shows that the success of Lesotho's zones will not depend on whether a zone is developed by the public or private sector, or both. All types of developer ought to have the opportunity to compete for SEZ licenses and be judged according to consistent approval criteria. Broadly, however, there are two models for zone development which ought to be facilitated:

- purely private models in which a private developer enters a competitive process for acquiring a zone license, that allows their designated zone to benefit from nationally determined SEZ incentives, set out in section 7.3.4. The process involves the submission of a zone masterplan by the private developer, which ought to be judged by Lesotho's SEZ authority according to consistent criteria, set out in the SEZ act; and,
- joint development through a public-private Special Purpose Vehicle (SPV) in which LNDC and one or more private actors enter a joint venture (typically through an SPV) to develop a zone, each with a different share of equity and designated responsibilities. Typically, the joint venture will be state led, requiring LNDC to conduct preliminary project preparation and competitively tender for an equity partner. The SPV may be vertically integrated (overseeing site and plot development and operations), or focused on a specific part of the development process.

The joint development approach would entail the structuring of SPVs delivering various functions (these can also be combined) namely:

- zone operation and provision of onsite services;
- development of internal zone infrastructure; and,

- development of zone facilities.

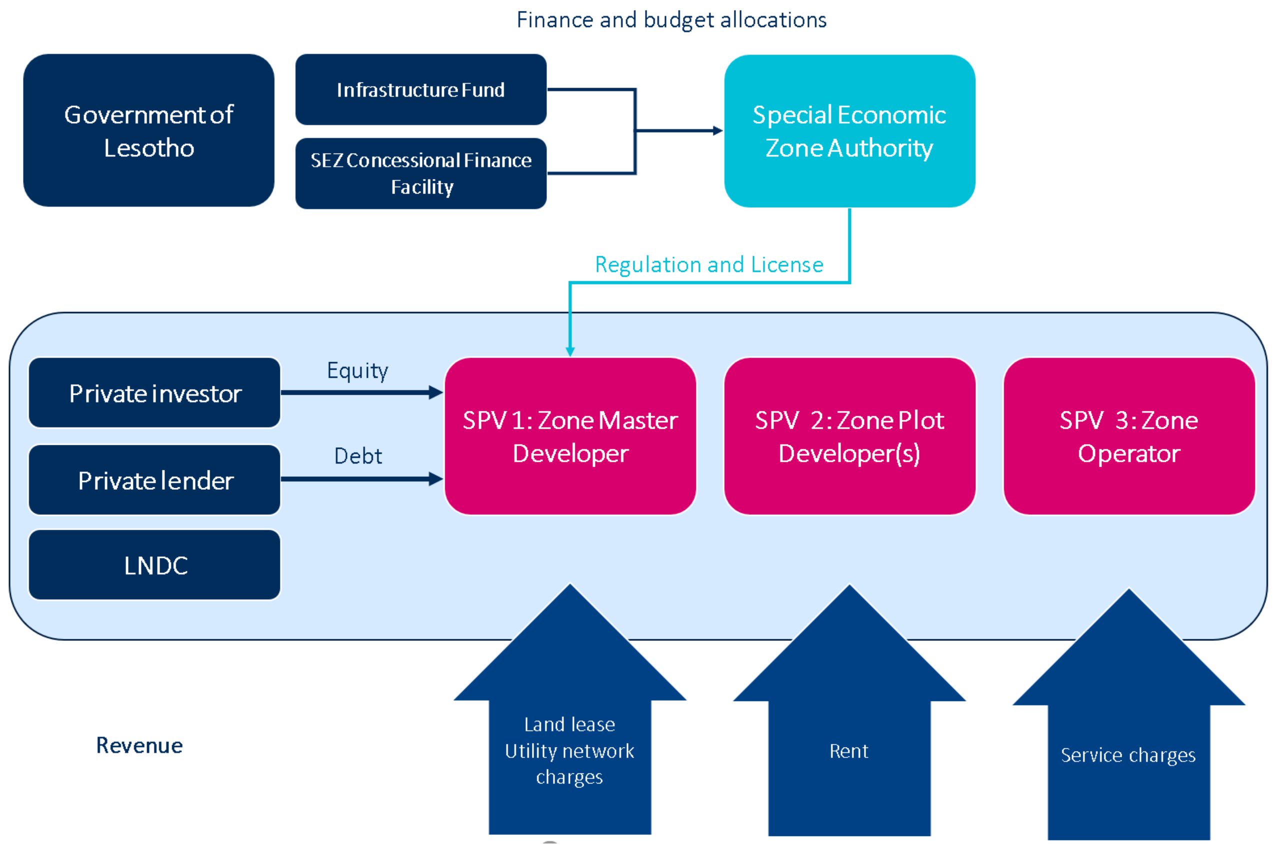
These three functions could be delivered in a number of different models, including different forms of public-private partnerships (Special Purpose Vehicle, Build Operate Transfer) or a direct contractual arrangement.

The zone delivery model adopted should seek to maximise the involvement of private sector participation, while ensuring risk is appropriately distributed between the public sector (SEZA or LNDC) and the private sector entity. Essentially, the activities associated with the development and ongoing operation of each zone should be assessed as separate entities or Special Purpose Vehicles (SPVs) whereby:

- SPV 1 serves as the 'master developer' and is the grantee of the SEZ development license, responsible for the overall site, including overseeing installation of on-site infrastructure to provide serviced plots to investors and or plot developers. SPV 1 leases land to tenants. It is most likely that LNDC will be a partner in these activities;
- SPV 2 is a plot develop, taking the serviced plots from SPV and building out the superstructures for occupation by tenants. Other third parties could also take on this role; and,
- SPV 3 manages the ongoing operations of the site.

This structure is outlined in Figure 23, below.

Figure 23 Models for delivery and private sector participation



Source: Vivid Economics

Attracting private interest will require creating a clear investor roadmap, highlighting the continued role of government at project preparation stages. All future models for zone development will continue to require some level of government support, as a result of the immaturity of Lesotho's SEZ regime and the associated high risks faced by the private investors. Government funding of transport infrastructure and financing site feasibility studies may be necessary to help attract private investors, for example. The government's recently established M 10 million Project Preparation Facility is already an important step which can be used to finance feasibility studies and deal-structuring activities. Though the support of government is essential, it should also be clear where government support ends to avoid crowing out private participation.

In future, the adoption of a competitive concession process for SEZ development may be appropriate. International experience shows that it generally produces better economic outcomes for the host country than do direct negotiations. Clarifying the intended approach appears all the more important in the context of the current absence of foreign and private zones in the country, and the lack of Government precedents or clarity around the type of anticipated PPP arrangements to be adopted in order ensure the best returns on any allocated State land for SEZ projects.

Lesotho's limited experience with PPPs implies that attention should be given to aligning Lesotho's offering with international best practice. Given that there is limited experience of PPPs in Lesotho, Lesotho's SEZ board must, in coordination with the MoF's PPP unit, seek to provide clarity over the type of PPP contract and tendering process. Global experience highlights the importance of transparent standard Developer Agreement content and a competitive tendering process to increase the likelihood of positive outcomes for government. To provide the support to the SEZ Authority to evaluate private proposals, it will be necessary to draw upon the expertise from MTI as well as other relevant Ministries/Agencies. Conditions which can help to attract high-quality developers in this tender process include:

- project and developer qualification conditions and criteria, such as demonstration of project financial viability and developer financial resources;
- demonstration of end-user market demand; and,
- demonstration of past developer experience in similar projects.

A full list of best practices for outcome-oriented PPPs is set out in Box 9.

7.5 Mitigating risks associated with SEZs

The recommendations set out in this section consider the risks and trends that characterise many SEZ regimes in Africa. Table 14 highlights the risks prevalent in SEZs across Africa. These risks pose a significant threat to attracting private developers and businesses in Lesotho. Proactive steps can help to mitigate these risks, set out below, and integrated throughout our recommendations for Lesotho.

Table 21 Key SEZ developer PPP risks and mitigation

Risk	Mitigation
Poor institutional coordination i.e. different incentives offered across the economy	Multi-agency SEZ committees Service Level Agreements and, or, laws designating responsibility to an SEZ agency
Regulatory uncertainty e.g. unpredictable changes in SEZ laws	Clear long-term government commitment, with high levels of government involved in designing SEZ policy
Lack of implementation capacity of an SEZ agency e.g. lack technical/ financial capacity to improve service provision	Capacity building initiatives Partnerships with successful SEZs in the region.

Risk	Mitigation
	Secure buy-in of Ministry of Finance to ensure for staff
Poor quality physical infrastructure due to inefficiencies in wider economy i.e. poor access to electricity or transport infrastructure outside of the zone	National reforms to improve physical infrastructure Access to international sources of infrastructure finance Phased approach so funds can be concentrated and recycled
Transaction Risk (i.e., market lacks confidence/understanding of deal; lack of Due Diligence on bidders)	Improve Market Information Higher Financial Disclosure & More Rigorous RFPs Consider financial incentives to reduce cost of capital, e.g. loan guarantees.
Market Risk (i.e., long-term demand / commercial uncertainty)	As above
Supervisory Capacity Risk	Robust Reporting Requirements Regular Contract Performance Reviews
Contract Rigidity Risk in dealing with project delivery challenges over time	Favour Contract "Tweaking" and Flexibility over Renegotiation clauses
Construction delays	Detailed construction Liquidated damages for delays Compliance monitoring & enforcement schedule
Developer does not develop or operate project to standards or according to the requirements of applicable law	Screen Developer against defined criteria Detailed guarantees/warranties for facilities, infrastructure, and services Developer will provide Liquidated damages for deficient performance by Developer Payment guarantee or performance bond from creditworthy entity
Related facilities upon which Developer's project relies not developed or operated in manner compatible, timely or to expectations	Government certification that facilities upon which Developer's project relies will meet requirements and not be modified adversely
Developer does not comply with environmental standards	Review mitigation plan based on permits, laws and donor standards Require use of best available technology for environmental controls

Risk	Mitigation
Lack of coordination/coherence with adjacent construction or activity	Careful monitoring of Developer's activities Representation from Developer that it has reviewed construction schedules of adjacent projects and has identified no conflicts
Developer does not satisfy payment obligations to Government	Screen potential developers for creditworthiness, reputation & experience Require Developer business plans & financial models Require Developer standby funding arrangement with a bank that will pay out if costs rise
Force Majeure / unforeseen events beyond control of parties	Include force majeure clause exempting party from non-performance for specified events Ensure Developer's agreements with users do not include force majeure provisions more generous than Developer's

Source: Locus Economica (2017-2019)

8 Action Plan

This section sets out a detailed action plan for a future SEZ regime in Lesotho, based on recommendations in Section 7.

The overall development of an SEZ Policy and the implementation of the recommendations in this action plan should be coordinated by the (interim) SEZ Authority. Recommendations on the establishment of this Authority are provided in section 7.4.1, including potential interim solutions whilst a standalone authority is under development. Whilst responsibility for accelerating the actions set out in this plan (including securing the necessary budget) should rest with the (interim) Authority, the effective implementation requires the buy-in and cooperation of a wide number of Government agencies. It is therefore vital that a senior steering committee at Ministerial level is established in line with the recommendations set out in section 7.4.2.

Individual actions for each recommendation presented have been prioritised across red, yellow and green priority categories to present a sequential action plan for delivering successful SEZs in Lesotho. These categories should be interpreted as follows:

- red category actions are 'upstream actions' that focus on improving the fundamental elements critical to the success of Lesotho's SEZs and impact the delivery of medium and low priority actions. These actions must be undertaken immediately;
- amber category actions are 'downstream actions' that are feasible only after the high priority actions are dealt with due to their dependency on these actions. These actions must be undertaken after the high priority actions; and
- green category actions are non-urgent but still important to deliver the regional economic development strategy presented in this report. Therefore, these must be undertaken after all other actions have been acted upon.

In the action plan presented in

Table 22, 'duration' indicates the number of months or years an action is expected to take to from inception to completion. The assessment categorises expected duration of each action into three groups: less than 6 months; 6 months to 1 year; 1 to 3 years; or ongoing, to reflect actions which are required throughout the lifetime of an SEZ.

Financial requirements are estimated for each action. The action plan categorises action-level financial estimates into five values: less than USD 100,000; USD 100,000 – USD 1,000,000; USD 1,000,000 – 10,000,000; more than USD 10,000,000. Where no costs are expected to be incurred from delivering an action, a financial requirement of 'none' is indicated. Where costs are less than USD 100,000, further detail is given on the relative magnitude of these costs. In cases where costs are reflective of staff time, we have included a note on this.

Stakeholders are identified for each action in the following roles:

- the 'Lead' stakeholder is expected to organise project delivery and ultimately be responsible for the action; and ,
- the 'Partner' stakeholders are institutions or organisations that are important to engage with to ensure maximum benefits and effective delivery for each action plan, including suggested sources of finance.

Table 22 An action plan to deliver Lesotho's SEZs

	Activity	Priority	Duration	Finance	Stakeholders
SEZ strategy and vision					
Recommendation 1.	Lesotho should develop an SEZ policy which sets out a clear vision for Lesotho's future SEZ regime and the need for an SEZ Law, prior to the development of any new zones.				
Action 1.1	The development of an SEZ Policy should be added as an action for the National Reform Authority.	●	Less than 6 months	Nil	*Lead:* Ministry of Trade and Industry *Partner:* National Reform Authority, Ministry of Development Planning, LNDC
Action 1.2	Draft an internal SEZ Policy proposal and submit to the Cabinet for approval. The SEZ policy should be based on recommendations in the SEZ Feasibility Study.	●	6 months to 1 year	Nil (neglible staff cost)	*Lead:* National Reform Authority *Partners:* Ministry of Trade and Industry, LNDC, Cabinet
Action 1.3	Specify in SEZ Policy that the National Reform Authority will create an SEZ Law, in cooperation with MTI.	●	6 months to 1 year	Nil. (cost included in Action 1.2)	*Lead:* National Reform Authority *Partners:* LNDC, Ministry of Trade and Industry, Parliament
Recommendation 2.	Lesotho should, as a matter of urgency, finalise its national Industrial Policy, with the SEZ policy explicitly contributing to its objectives.				
Action 2.1	Draft an Industrial Policy which sets out Lesotho's SEZ Policy, the objectives of SEZs, and their contribution to national industrial policy.	●	6 months to 1 year	Nil	*Lead:* Ministry of Trade and Industry

	Activity	Priority	Duration	Finance	Stakeholders
				(included in ongoing activities already budgeted for)	*Partners:* National Reform Authority, Central Planning Unit
Action 2.2	Finalise Lesotho's medical cannabis regulation.		6 months to 1 year	Nil (included in ongoing activities already budgeted for)	*Lead:* Ministry of Health *Partners:* LNDC
Recommendation 3.	The objective of Lesotho's SEZs should be to maximise investment in high value production.				
Action 3.1	Specify in SEZ Policy (see Action 1.2) and Industrial Policy (see Action 2.1) that the objective of SEZs is to maximise investment in high value production.		6 months to 1 year	Nil (cost included in Action 1.2)	*Lead:* National Reform Authority *Partners:* Ministry of Trade and Industry, Ministry of Development Planning
Recommendation 4.	The objective of Lesotho's Industrial Estates should be explicitly stated as maximising employment.				
Action 4.1	Specify in SEZ policy (see Action 1.2) and Industrial Policy (see Action 2.1) that the objective of Industrial Estates to maximise employment.		6 months to 1 year	Nil (cost included in Action 1.2)	*Lead:* National Reform Authority *Partners:* Ministry of Trade and Industry, Ministry of Development Planning
Recommendation 5.	The SEZ Policy should indicate priority sectors in manufacturing, but implementation should remain flexible and responsive to demand, including in the service sector.				
Action 5.1	Specify in SEZ policy (see Action 1.2) and Industrial Policy (see Action 2.1) the large		6 months to 1 year	Nil	*Lead:* National Reform Authority

	Activity	Priority	Duration	Finance	Stakeholders
	opportunities for manufacturing industry in Lesotho's SEZs.			(cost included in Action 1.2)	*Partners:* Ministry of Trade and Industry, Ministry of Development Planning
Recommendation 6.	Risk assessments should be undertaken to understand the impact of permitting investments in different sectors from locating within the SEZs.				
Action 6.1	Establish a list of 'precluded' sectors, which are to be discouraged in Lesotho's SEZs.	●	Less than 6 months	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* Ministry of Trade and Industry, Ministry of Development Planning
Action 6.2	Establish a list of 'low priority' sectors, which will require a risk assessment by the SEZ Authority Board (or interim SEZ unit) before attaining a business license.	●	Less than 6 months	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* Ministry of Trade and Industry, Ministry of Development Planning
Action 6.3	Develop a risk assessment framework for reviewing whether to allow investment in 'low priority' sectors.	●	Less than 6 months	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* Ministry of Trade and Industry, Ministry of Development Planning

	Activity	Priority	Duration	Finance	Stakeholders
Action 6.4	Develop and publish a zone developer license, which specifies the 'precluded' and 'low priority' sectors.		Less than 6 months	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* Ministry of Trade and Industry, Ministry of Development Planning
Action 6.5	Decide whether activities classified as 'low priority' are granted a business license in a zone on a case by case basis, using the risk assessment framework.		Ongoing	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* Ministry of Trade and Industry, Ministry of Development Planning
Action 6.6	Decide whether a zone developer license guarantees that specific 'low priority' activities are granted a business license in an SEZ on a case by case basis, using the risk assessment framework.		Ongoing	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* Ministry of Trade and Industry, Ministry of Development Planning
Recommendation 7.	SEZs should not be used as the primary tool for regional economic rebalancing.				
Action 7.1	See Action 3.1				
Recommendation 8.	Lesotho's SEZ strategy should be structured around the development of hybrid zones that are flexible to align with investor demand within the context of relevant policies.				

	Activity	Priority	Duration	Finance	Stakeholders
Action 8.1	Consider the option of developing a Hybrid Zone on a case by case basis, depending on investor demands.		Ongoing	Nil	*Lead:* LNDC *Partners:* SEZ Authority Board (or interim SEZ unit)
Recommendation 9.	Eligible investors should be free to locate within an SEZ or Industrial Estate.				
Action 9.1	Permit all types of investor in SEZs and Industrial Estates, under the condition that they are permitted under the developer license or are 'low priority' activities authorised by the SEZ Authority Board.		Ongoing	Nil	*Lead:* interim SEZ unit (or SEZ Authority Board)
Recommendation 10.	SEZ development should be reflected in the National Spatial Strategy, reflective of where there is investor demand for clustering and agglomeration.				
Action 10.1	Draft Lesotho's National Spatial Strategy to include information on where SEZs are planned and how they will be linked to other clusters of economic activity in Lesotho.		Less than 6 months	Nil (included in ongoing activities already budgeted for)	*Lead:* Office of the Commissioner of Lands *Partners:* National Reform Authority, SEZ Authority Board (or interim SEZ unit), Ministry of Local Government and Chieftainship, Cabinet subcommittees on land management and infrastructure
Action 10.2	Consult Lesotho's National Spatial Strategy when reviewing proposals for zone developer licenses to check if there is clustering of investor demand.		Ongoing	Nil (negligible staff costs)	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* Ministry of Local Government and Chieftainship,

	Activity	Priority	Duration	Finance	Stakeholders
					Cabinet subcommittees on land management and infrastructure
Recommendation 11.	Zones should be developed through a phased approach to allow room for growth, aligned with National Spatial Strategy timelines, including a pilot where there are credible development models in place (e.g. Mafeteng).				
Action 11.1	Establish a SLA between Ministry of Trade and Industry and LNDC, setting out the responsibilities of LNDC in the development of pilot SEZs. This should specify LNDC's role in developing SEZ Master Plans.	●	Less than 6 months	Nil (negligible staff costs)	*Lead:* Ministry of Trade and Industry *Partners:* LNDC
Action 11.2	Until the SEZ Authority is operational, establish MOUs between the interim SEZ unit and government ministries or parastatal bodies who will be responsible for providing services to the pilots SEZs.	●	Less than 6 months	Nil (negligible staff costs)	*Lead:* Ministry of Trade and Industry *Partners:* Land Administration Authority, Ministry of Local Government and Chieftainship, WASCO, Companies Registrar, Ministry of Development Planning, Ministry of Finance, LRA, Ministry of Agriculture and Food Safety, Ministry of Labour, Ministry of Home Affairs, Social Security Fund, PPP unit
Action 11.3	Engage potential private sector developers who could be interested in jointly developing a pilot SEZ in Lesotho.	●	Less than 6 months	Nil (negligible staff costs)	*Lead:* LNDC *Partners:* Ministry of Trade and Industry, Ministry of Foreign Affairs

	Activity	Priority	Duration	Finance	Stakeholders
Action 11.4	Develop a PPP contract between LNDC and the selected private developer of the pilot SEZ. This should specify the type of corporate vehicle that will be legally responsible for SEZ development and LNDC's obligations and liabilities.		Less than 6 months	< USD 100,000 (cost of existing staff)	*Lead:* LNDC *Partners:* Ministry of Trade and Industry
Action 11.6	To complete Action 11.5, LNDC should hire transaction advisors who can advise on procurement of a private developer and PPP deal structuring.		Less than 6 months	USD 100,000 – USD 1,000,000 (cost of newly hired staff)	*Lead:* LNDC *Partners:* Ministry of Trade and Industry
Action 11.7	Finalise the zone masterplan for the pilot SEZ.		Less than 6 months	Nil (included in ongoing activities already budgeted for)	*Lead:* LNDC, private partner in PPP *Partners:* SEZ Authority Board (or interim SEZ unit), Ministry of Trade and Industry
Action 11.8	Submit a request for a zone developer license to the SEZ Authority Board (or interim SEZ unit). This proposal should include the masterplan for the pilot SEZ.		Less than 6 months	< USD 100,000 (cost of existing staff)	*Lead:* LNDC, private partner in PPP *Partners:* SEZ Authority Board (or interim SEZ unit)
Action 11.9	Support the consolidation land for the pilot SEZs.		6 months to 1 year	Nil. To be reviewed following the PPP contract.	*Lead:* LNDC, private partner in PPP *Partners:* Office of the Commissioner of Lands, Ministry of Local Government and Chieftainship

	Activity	Priority	Duration	Finance	Stakeholders
Action 11.11	Organise quarterly 'market linkage' meetings between investors and developers in Lesotho's SEZs and local firms. Engage with BEDCO's business incubators and Lesotho's export development programme to establish local firms that could participate in these meetings.		Ongoing (quarterly)	< USD 100,000 (cost of existing staff)	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* BEDCO, LNDC, Central Planning Unit
Recommendation 12.	Learning and evaluation activities should be purposefully designed for both 1) pilot phase and 2) in regular intervals, such as the conclusion of a five-year policy.				
Action 12.1	Specify in SEZ policy a list of key performance indicators, which will be used to track the performance of zones.		Less than 6 months	Cost included in Action 2.1	*Lead:* National Reform Authority *Partners:* Ministry of Trade and Industry, Ministry of Development Planning
Action 12.2	Produce an annual assessment report on the performance of each SEZ for the Cabinet.		6 months to 1 year	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* SEZ developers and operators, zone one-stop shop
Recommendation 13.	Formal relationships should be developed with South Africa's SEZ programme, allowing partnerships with key zones in South Africa and those in Lesotho, allowing for facilitated inter-zone trade flows.				
Action 13.1	Establish a SLA between the SEZ Authority and the Ministry of Foreign Affairs which stipulates that SEZs are a monthly agenda item during		Less than 6 months	Nil (negligible staff costs)	*Lead:* SEZ Authority Board

	Activity	Priority	Duration	Finance	Stakeholders
	meetings with the South Africa's Department of International Relations and Cooperation.				*Partners:* MFA Lesotho, DIRCO South Africa, LNDC
SEZ incentive offering					
Recommendation 14.	**Fiscal incentives should be introduced to lower the effective tax rate in SEZs and encourage investment that raises productivity.**				
Action 14.1	Minister of Finance issues a regulation that: - building and machinery financed in SEZs are eligible for accelerated depreciation (of 100% of capital expenditure)		6 months to 1 year	Nil (negligible staff costs)	*Lead:* Minister of Finance *Partner:* SEZ Authority Board (or interim SEZ unit), LRA
Recommendation 15.	**VAT and customs duties should be suspended on goods sold into or within the zone.**				
Action 15.1	Minister of Finance issues regulations that: - all domestic goods and services sold into an SEZ are exempt from VAT and duty drawback. - all machinery and capital equipment imported into an SEZ are exempt from VAT and duties. - all goods and services sold to another business located within an SEZ are VAT exempt.		6 months to 1 year	Nil (negligible staff costs)	*Lead:* Minister of Finance *Partner:* SEZ Authority Board (or interim SEZ unit), LRA
Action 15.2	Consider the option of ensuring goods and services imported into the zone are duty exempt.		6 months to 1 year	Nil	*Lead:* Minister of Finance

	Activity	Priority	Duration	Finance	Stakeholders
					Partner: SEZ Authority Board (or interim SEZ unit), LRA
Recommendation 16.	Lesotho should engage with international finance institutions to create a concessional finance facility for SEZ investments.				
Action 16.1	Engage with stakeholders in the African Development Bank (AfDB) and other stakeholders on developing an Infrastructure Fund offering concessional finance for, or associated with, SEZ related infrastructure capital investments.		1 to 3 years	> USD 10,000,000 required to finance necessary infrastructure	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partner:* AfDB
Recommendation 17.	Lesotho should create an SEZ facility which contributes towards the costs of capital expenditure on technology, machinery and equipment, training, and research and development.				
Action 17.1	Establish an SEZ fund to finance the provision of incentives, including infrastructure, highlighted in the SEZ feasibility study.		6 months to 1 year	USD 100,000 – USD 1,00,000 required to initially capitalise the SEZ fund	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* Ministry of Finance, Ministry of Trade and Industry
Action 17.2	Request money from the annual budget to capitalise the SEZ fund.		Annual	> USD 10,000,000 required so that fund can provide necessary infrastructure. The timing of this cost will be spread out and depend on the pace of SEZ development.	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partners:* Ministry of Finance, Ministry of Trade and Industry

	Activity	Priority	Duration	Finance	Stakeholders
Recommendation 18.	Ensure internationally competitive levels of utility and infrastructure service to new industrial land sites (off-site and on-site).				
Action 18.1	Set minimum standards for the provision of on-site infrastructure in every zone developer license, including health and safety and emergency service provision.		Less than 6 months	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit *Partner:* LNDC
Action 18.2	Establish a SLA between the SEZ Authority Board and the MPW to develop infrastructure surrounding zones as requested and financed by the SEZ Authority Board.		Less than 6 months	Nil (negligible staff costs)	*Lead:* SEZ Authority Board *Partner:* Ministry of Public Works and Transport
Action 18.3	Establish an SLA between the SEZ Authority Board and WASCO to a) provide guaranteed water supply to each SEZ at agreed prices and to b) prioritise the SEZ's connections to the water network.		Less than 6 months	Nil (negligible staff costs)	*Lead:* SEZ Authority Board *Partner: WASCO, SEZ* one-stop shop, Ministry of Energy, Meteorology and Water Affairs
Action 18.4	Establish an SLA between the SEZ Authority Board and LEC to a) guarantee electricity supply to each SEZ and b) prioritise the SEZ's connections to the national electricity grid.		Less than 6 months	Nil (negligible staff costs)	*Lead:* SEZ Authority Board *Partner:* LEC
Action 18.5	Specify in the SEZ law that SEZ developers can install and sell distributed generation to businesses within the zone.		6 months to 1 year	Cost included in Action 24.1	*Lead:* National Reform Committee *Partner:* Ministry of Energy, Meteorology and Water Affairs, LEC

	Activity	Priority	Duration	Finance	Stakeholders
Recommendation 19.	Transition from the subsidised support of rents to funding enhanced shared infrastructure across LNDC portfolio.				
Action 19.1	Consider removing the provision of rental subsidies in Industrial Estates.	●	1 to 3 years	Nil	*Lead:* LNDC *Partner:* SEZ Authority Board, Ministry of Finance
Recommendation 20.	Enhance border infrastructure enabling easier cross-border transit of goods and feedstock associated with the zones.				
Action 20.1	Consider establishing bonded rail transport between Lesotho's zones and international borders.	●	1 to 3 years	> USD 10,000,000	*Lead:* SEZ Authority Board *Partner:* Ministry of Public Works and Transport
Recommendation 21.	Consider land reforms enabling wholly private ownership of land (or long-term protected land leases) for SEZ investors and developers.				
Action 21.1.	Consider allowing foreign ownership of land in Lesotho's SEZs.	●	1 to 3 years	Nil	*Lead:* SEZ Authority Board *Partner:* Office of Commissioner of Lands, Ministry of Local Government and Chieftainship, Ministry of Forestry and Land Reclamation
Recommendation 22.	A one-stop-shop (extension of OBFC) should be established in each zone to provide a range of business support and regulatory services which are core to the SEZ value proposition.				

	Activity	Priority	Duration	Finance	Stakeholders
Action 22.1	Specify in the SEZ Policy that responsibilities of the OBFC towards investors in zones will include: - streamlining administrative purposes - fast-tracking business regulations - investor aftercare services		Less than 6 months	Included in Action 2.1	*Lead:* National Reform Authority *Partner:* OBFC, Ministry of Trade and Industry
Action 22.2	Establish an SLA between the SEZ Authority and OBFC to provide a one-stop shop in each zone.		Less than 6 months	Nil (negligible staff costs)	*Lead:* SEZ Authority Board *Partner:* OBFC, Ministry of Trade and Industry
Recommendation 23.	Ensure the provision of business support services, preferably through engaging the private sector in a PPP.				
Action 23.1	Review which business support services are valuable to potential investors in Lesotho's SEZs, and are not currently provided by the private sector.		Ongoing	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partner:* SEZ one stop shop, SEZ Authority Board
Action 23.2	Competitively tender for the private or joint private public provision of business support services on a case by case basis.		Ongoing	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partner:* SEZ one stop shop, LNDC
SEZ institutional and regulatory framework					
Recommendation 24.	An SEZ Authority should be established through an SEZ Act.				

	Activity	Priority	Duration	Finance	Stakeholders
Action 24.1	Develop an SEZ bill and present to Parliament.		6 months to 1 year	< USD 100,000 (costs of staff)	*Lead:* National Reform Authority *Partner:* Ministry of Trade and Industry, Parliament
Action 24.2	Specify the creation of an SEZ Authority in the SEZ law. The Law will specify that the responsibilities of the SEZ Authority include acting as SEZ regulator, contracting point for SLAs and advisor on SEZ policy.		6 months to 1 year	USD 100,000 to 200,000 to cover costs of four full time staff and their physical and digital infrastructure (e.g. workspace, website). These costs are delayed until the Board is set up. Before then, there are staff costs for the interim SEZ unit, covered in Action 29.1	*Lead:* National Reform Authority *Partner:* Ministry of Trade and Industry, Parliament
Recommendation 25.	The creation of a favourable business environment in SEZs should be achieved principally through service level agreements with relevant ministries, authorities and parastatals.				
Action 24.3	Establish SLAs between the SEZ Authority and relevant ministries, authorities and parastatals, as recommended in the SEZ Feasibility Study.		6 months to 1 year	Nil (negligible staff costs)	*Lead:* Ministry of Trade and Industry *Partners:* Land Administration Authority, Ministry of Local

	Activity	Priority	Duration	Finance	Stakeholders
					Government and Chieftainship, WASCO, Companies Registrar, Ministry of Development Planning, Ministry of Finance, LRA, Ministry of Agriculture and Food Safety, Ministry of Labour, Ministry of Home Affairs, Social Security Fund, PPP unit (among others)
Recommendation 26.	Prioritise the development of a robust PPP law and policy framework in Lesotho.				
Action 26.1	Develop best practice legal framework and guidelines for engaging in PPPs in Lesotho, as recommended in the SEZ Feasibility Study. This should include a framework for assessing private sector developers.		6 months to 1 year	< USD 100,000 (costs of staff)	*Lead:* National Reform Authority *Partner:* Ministry of Finance, PPP Unit, SEZ Authority Board (or interim SEZ unit)
Action 26.2	Develop and publish a standard Developer Agreement for private sector parties engaging in PPPs in Lesotho's SEZs.		6 months to 1 year	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partner:* Ministry of Finance, National Reform Authority, PPP Unit
Recommendation 27.	The SEZ Authority Board should consist of key Ministers, with representation from the private sector, and chaired by either the Prime Minister of Deputy Prime Minister.				
Action 27.1	Specify in the SEZ law that the SEZ Authority Board should be an inter-ministerial committee, which includes:		Less than 6 months	Staff costs included in Action 24.2	*Lead:* National Reform Authority

	Activity	Priority	Duration	Finance	Stakeholders
	- the Deputy Prime Minister (Chair); and representatives from: - the Ministry of Trade and Industry (Secretary); - the Ministry of Local Government; - the Ministry of Development Planning; - the Ministry of Finance; - a representative of the organized private sector, from Lesotho's Chamber of Commerce; and, - Ministry of Agriculture & Food Safety - Ministry of Labour.				*Partner:* Deputy Prime Minister, Ministry of Trade and Industry, Ministry of Local Government and Chieftainship, Ministry of Development Planning, Ministry of Finance, Lesotho Chamber of Commerce, Ministry of Agriculture and Food Safety, Ministry of Labour
Recommendation 28.	LNDC's role should focus on the promotion and development of SEZs				
Action 28.1	Establish an MOU between the SEZ Authority Board and LNDC which sets out LNDC's responsibility in promoting Lesotho's SEZ programme.		Less than 6 months	Nil (negligible staff costs)	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partner:* LNDC
Recommendation 29.	An interim solution may be to establish an SEZ Unit in the Prime Minister's Office, with service level agreements between responsible Ministries and the LNDC (as a development partner)				
Action 29.1	Until the creation of the SEZ Authority Board, an SEZ Unit should be established as an interim SEZ regulator in the Prime Minister's office.		Less than 6 months	< USD 100,000 (costs of staff)	*Lead:* National Reform Authority *Partner:* Ministry of Trade and Industry, Central Planning Unit

	Activity	Priority	Duration	Finance	Stakeholders
Recommendation 30.	The full spectrum of public, private and PPP SEZs should be permissible				
Action 30.1	Review requests for a developer license from public sector, private sector and PPPs using the framework established by Action 31.2.		Ongoing	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit)
Recommendation 31.	Private sector involvement in the development and operation of zones should be encouraged through a) legal eligibility of private developers in tenders for zone licenses, and b) government incentives to attract private developers through financing of feasibility studies and best practice PPP arrangements.				
Action 31.1	Publish an investor roadmap which sets out the steps private developers will be required to take to develop an SEZ. This should include guidelines on how to acquire a zone developer license and acquire land in Lesotho's SEZs.		Less than 6 months	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partner:* Ministry of Trade and Industry, LNDC
Action 31.2	Establish a framework to assess proposals for a zone developer license.		Ongoing	Staff costs included in Action 24.2	*Lead:* SEZ Authority Board (or interim SEZ unit) *Partner:* Central Planning Unit, LNDC
Action 31.3	Utilise Lesotho's project preparation facility to finance feasibility studies for future SEZs.		Ongoing	USD 100,000 – 1,000,000 (costs of hiring professional advisors)	*Lead:* LNDC
Action 31.4	See Action 26.1 and 26.2				

8.1 Action Plan: logical chain

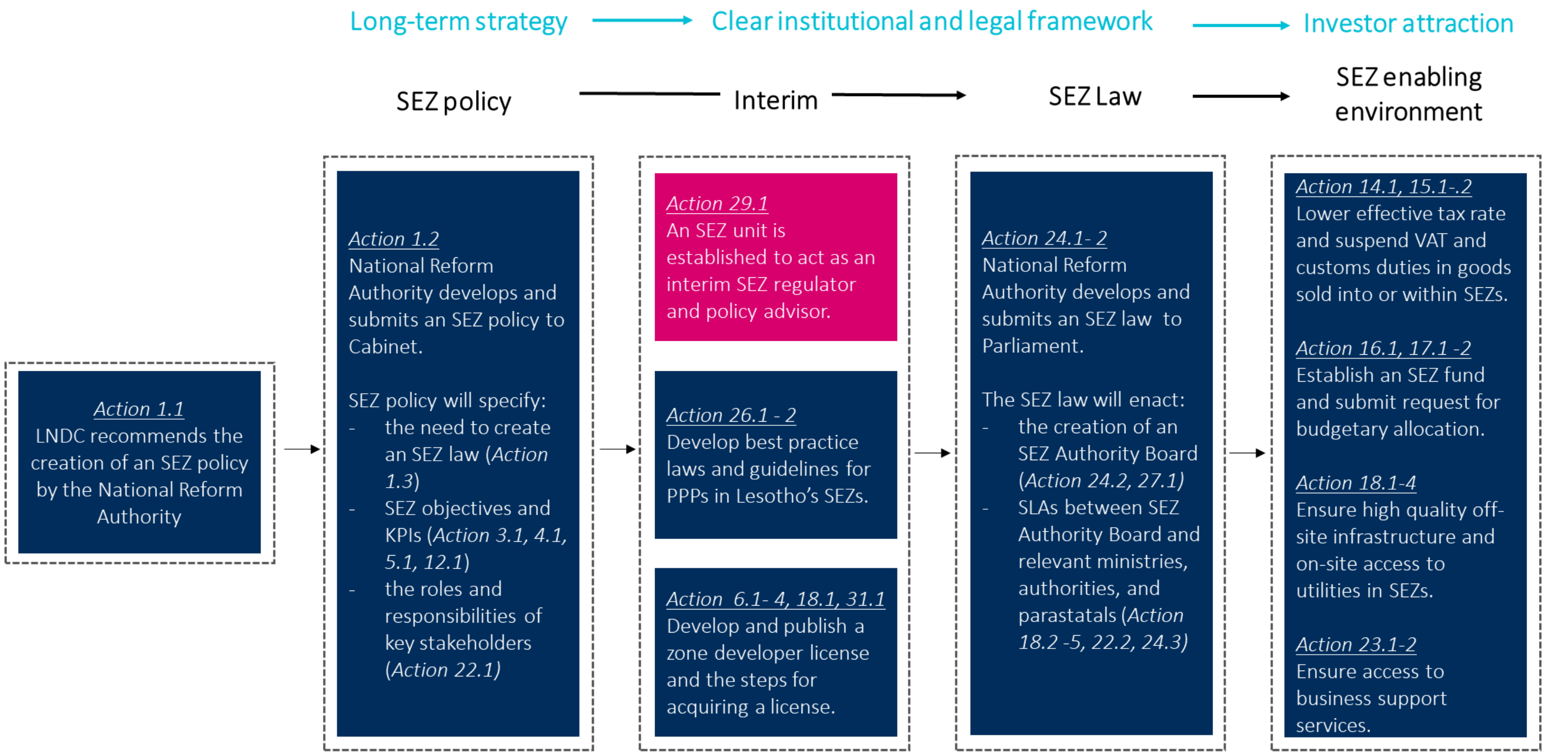
This section sets out the sequencing of actions, highlighting the interdependence on different actions and the importance of a clear phased implementation plan.

8.1.1 Logic chain: establishing an SEZ programme

Figure 24 identifies the steps required to create a successful SEZ programme in Lesotho. The logical chain of actions follows the below structure:

- firstly, identify the long-term strategy of Lesotho's SEZs and communicate this strategy by developing an SEZ policy to be proposed to the Cabinet;
- secondly, develop the legal and institutional framework to support SEZs, by developing an SEZ bill to be presented in Parliament;
- thirdly, once the SEZ Law is enacted and the SEZ Authority Board has been appointed, the Authority can improve the incentive offering in SEZs; and finally,
- until the SEZ law is approved by Parliament, set up an interim SEZ unit to oversee regulation concerning pilot SEZs, including the development of zone developer licenses and PPP developer contracts. Once the SEZ law is established, the inter-ministerial SEZ Authority Board can take over responsibilities previously held by the SEZ unit.

Figure 24 Logical chain of actions to develop an SEZ programme



Source: Vivid Economics

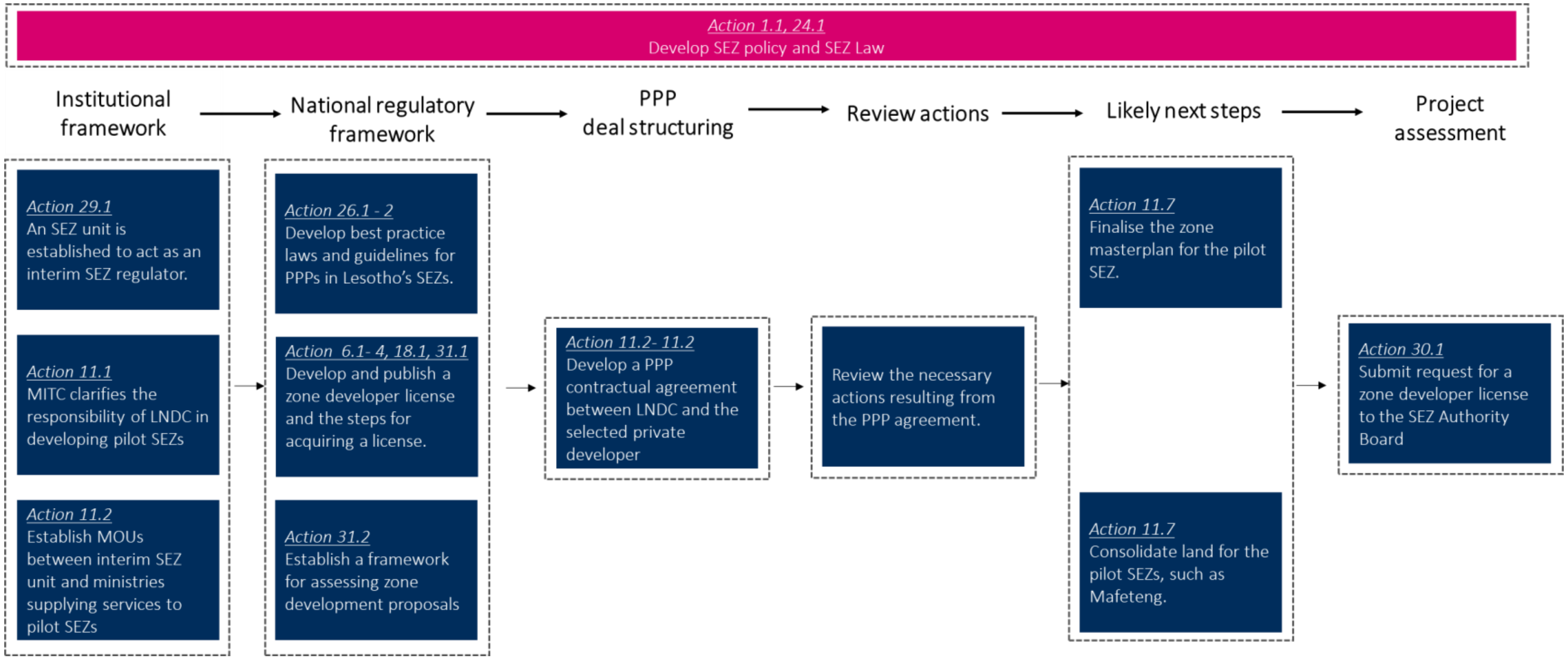
8.1.2 Logic chain: launching a pilot SEZ

Figure 25 identifies the steps required to create a successful pilot SEZ programme in Lesotho. In principle a pilot SEZ should only be launched until after the sequence of actions in Figure 24 is completed. Proposals to develop a new site in Mafeteng imply that a new SEZ could be established prior to the approval of an SEZ policy and SEZ law, however. Given the imminent need to clarify the future of Mafeteng, the logical chain of actions should follow the below structure:

- firstly, clarify the roles and responsibilities of key stakeholders involved in the development of a pilot SEZ in Mafeteng;
- secondly, develop the regulatory guidelines to engage private sector developers in the joint development of a future zone;

- thirdly, once the guidelines for establishing an SEZ have been reduced (or in parallel to these guidelines being produced), LNDC should establish a PPP agreement between the selected private sector developer and LNDC which sets out the liabilities of each party;
- actions related to development and operation of the zone will depend on the contractual agreement established in the PPP and will need to be assessed after this has been created. However, likely next steps will include the consolidation of land and the finalisation of the zone master plan;
- finally, once a feasibility study for the site is complete, the SEZ unit ought to review the proposal for a pilot SEZ to assess the credibility of its business plan before approving a zone developer license.
- Whilst the actions to develop a pilot SEZ can precede the creation of an SEZ policy and SEZ law, they will benefit from the existence of this policy and legal framework. As a result, it is encouraged that the creation of an SEZ policy and SEZ law is completed prior to the launch of a pilot SEZ in Mafeteng or carried out in parallel to the development of a new zone.

Figure 25 Logical chain of actions to develop a public sector led PPP SEZ pilot in Mafeteng



Source: Vivid Economics

Appendix

List of potential private sector developers in South Africa

Abland

Commercial, Retail, Industrial developers

https://abland.co.za/

Atterbury Property Investments

Commercial and Industrial developers and project managers

https://www.atterbury.co.za/

Eris Property Group

Commercial and Industrial developers and project managers

www.eris.co.za

RPP Developments

Commercial, retail, industrial, institutional and residential property development and management

https://rpp.co.za/

Growth point Properties

Commercial, retail, industrial, institutional and residential property development and management

https://growthpoint.co.za/

REDEFINE

Commercial & industrial property developers

https://www.redefine.co.za/

A J Dougherty Consulting
Property development consultancy.
www.ajdconsulting.co.za

Abland Commercial Property Developer
www.abland.co.za

Akhona Properties
A broad-based, black empowered company dealing with all aspects of commercial, retail and industrial property management and includes some of South Africa's most prestigious property owners among its client list.
www.akhona.co.za

Allrand
Property broking and consulting, development and site assembly of stands and offices. Advising clients on property-

related investment opportunities.
www.allrand.co.za

Amdec Property Developments
Offers services including property development, property construction, renovations, land facilitation, project management.
www.amdec.co.za

Anderson & Anderson International
Architects, property valuators and estate agent in Southern Africa.
www.anderson-anderson-int.com

Arun Holdings (PTY) LTD
Established 1997 is a property development company situated in Somerset West, Western Cape. View our current, completed and future projects.
www.arun.co.za

Aska Property
Property Development
www.askaproperty.com

At Home Properties
Upmarket developments in Sandton and Johannesburg.
www.homeproperties.co.za

Bellandia
One of the largest, best-known and respected single residential, group housing and sectional title developers in the Western Cape.
www.bellandia.co.za

Blue Bean Construction
A construction and development company in Pretoria.
www.blueb.co.za

Bluegate Properties – Property Development – Western Cape
A property development company situated in Rondebosch, Cape Town, South Africa.
www.bluegate.co.za

Bondsure Consulting
Specialists in dynamic residential property development projects and commercial property for investment purposes.
www.info-bahn.co.za

Brydens Group
Property development and project management.
www.brydensgroup.com

Byron Yeats Properties
South African real estate and property developments from Camps Bay to Langebaan.
www.byron-yeatsproperties.com

Canboria Investments
Residential and office property developers.
www.canboria.co.za

Cape Atlantic Projects
Develop and sell properties in Cape Town.
www.capeatlanticprojects.co.za

Cape Atlantic Properties
Developing and selling properties on the Atlantic Seaboard, based in Cape Town, South Africa.
www.capeatlanticprojects.co.za

Chesterwood Projects
Independent Property Development Company In South Africa offering an extensive range of consulting services in the field of property
www.chesterwoodprojects.co.za

City Scope Town Planning Services
Specialises in providing Town Planning Services.
www.cityscope.co.za

Colliers RMS
Property management company in Sandton
www.colliers.co.za

Degoede
Property development and management.
www.degoede.co.za

DPM Developments
Have been continuously active in developing a diversity of high quality residential and commercial properties in South Africa.
www.dpmdevelopments.co.za

EARP Projects – Property Developers
Developing and building homes in South Africa since 1972. Thirty years in the building industry serves only as a testament to the quality, workmanship and service of EARP Projects.
www.earp.co.za

Earthstone
Property Development in and around Pretoria/Thswane (Menlyn, Menlopark, Brooklyn, Lynnwood), Gauteng, South Africa.
www.earthstone.co.za

Elevation Property Group
Johannesburg property, Gauteng commercial property, property leasing, commercial property sales, property acquisitions.
www.elevation.co.za

Eurocape Property Development
A South African investment and property development company, set to change the face of modern city living in South Africa.
www.eurocape.co.za

EVS Planning
Town and regional planners providing to the public and private sectors. Consulting town and regional planning and property consultancy services as well as project management.
www.evsplanning.co.za

Geo Rennie Ford
Property developers in Boksburg, petrol garage site facilitation, property development.
www.grf.co.za

Glowfish
Property development South Africa.
www.glowfishdevelopment.com

Golden Acre
Parkside Umhlanga Ridge – Apartments and Offices For Sale and Retail Space To Let in Kwazulu Natal.
www.manhattanprop.co.za

Grandhill Gateway
Residential & Commericial Property Development in Umhlanga.
www.grandhill.co.za

Grid Group
Our website showcases Grid Construction, Grid Developments and Grid Rentals. The Grid Group are leading property developers and contractors.
www.grid.co.za

Group 3 Properties
Commercial and residential property development.
www.group3properties.com

Group 6 Developments
A leading South African property development company.
www.groupsix.co.za

Hart Property Development
For professional development, construction and project management expertise and service.
www.hartproperty.com

HSK Simpson & Partners – Turning Data into Information
Cadastral surveys and property development consultants. Sectional title surveyors. Engineering and topographic surveyors.
www.hsk.co.za

Hubut Investments
Gives you a one-stop solution for your construction projects.
www.hubuta.co.za

INTERSITE Property Management Services
Manage and develop the public sector property portfolios.
www.intersite.co.za

Key Projects
Consultants to the property development industry.
www.keyprojects.co.za

Keymax Property Development
Property development in South Africa.
www.keymaxprop.co.za

Liege
Property consulting company offering complete building management solutions – Garden Route, South Africa.
www.liege.co.za

Mziwethu Property development
Property development and construction.
www.mziwethu.co.za

PRO-PLAN DEVELOPMENTS (PTY) LTD - Commercial & industrial property developers
http://proplansa.co.za/

(011) 463-1059

Sedgeley Developers
Developers of commercial, retail, industrial and residential property in South Africa.
www.sedgeley.co.za

Zotos Property Group – Over 35 years and 10 000 Homes Built
One of the leading residential & commercial property developers in South Africa.
www.zotos.co.za

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Company profile

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