Special Economic Zones - An Indian Perspective

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Special Economic Zones (SEZs) have been established as an instrument to enhance the acceptability and the credibility of the transformation policies, to attract domestic and foreign investment and also for further opening up of the economy. Despite its benefits, SEZ has become the most controversial issue for India in recent years. Concerns have also been expressed on the displacement of farmers by land acquisition, loss of fertile agricultural land, a huge revenue loss to the exchequer and adverse consequences of uneven growth.

Keyword : SEZ, Libralisation

Introduction

India over the past decade has progressively opened up its economy to effectively face new challenges and opportunities of the 21st Century. To compete in the global market, the Government of India (GoI) has liberalised export policies & licensing of technology and implemented tax reforms providing various incentives. Special Economic Zones (SEZs) have been established as an instrument to enhance the acceptability and the credibility of the transformation policies, to attract domestic and foreign investment and also for further opening up of the economy. Despite its benefits, SEZ has become the most controversial issue for India in recent years. The advocates of the policy consider it as supersonic engine of growth, while others severely criticize it as the latest land grab instrument in the hands of the industrialists. Dissenters contend that the SEZ policy would be misused for real estate development rather than for generating exports. Concerns have also been expressed on the displacement of farmers by land acquisition, loss of fertile agricultural land, a huge revenue loss to the exchequer and adverse consequences of uneven growth. Of much more concern however is the fact that there are differences within the government too. The Congress president Sonia Gandhi has also expressed her reservations over the impact of SEZ policy on displaced farmers and the Reserve Bank of India has asked the banks to treat SEZ lending as real estate business and not infrastructure.

This article revisits the debate. It describes the evolution of SEZs in India, examines India's experience with SEZs, describes the economic rationale for SEZs and discusses the road ahead.

Evolution: From EPZs to SEZs

India made far-reaching changes in its economic policies from a licence-quota- permit raj to LPG (Liberalisation-Privatisation-Globalisation) policy. The reformed trade and industrial policy eliminated licensing requirements for private domestic and foreign investment in certain industries and relaxed the restrictions under the Monopolies and Restrictive Trade Practices Act on expansion, diversification, mergers and acquisitions by large firms and industrial houses. Emphasis was laid on export promotion policy instead of the earlier import substitution based development strategy. However, the earlier reform period did not result in a sustainable growth in manufacturing and there was a significant slowdown in the second-half of the 1990s. Bureaucratic red tape, administrative procedures, rigid labor laws and poor infrastructure are believed to have affected the investment

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climate adversely in the manufacturing sector. To address these issues, the government reverted to EPZs with the expectation that if they could effectively be separated from the rest of the economy, they could provide the "engine of growth" to propel the manufacturing sector. With this view the first EPZ in India was set up in Kandla, Gujarat in 1965. The Santacruz EPZ in Mumbai came into operation in 1973. Seven more zones were set up thereafter. However, the EPZ could not emerge as an effective instrument for export promotion on account of multiplicity of factors like limited power of zonal authorities, absence of single window facility within the zone, rigid custom procedures for bonding and bank guarantees, restrictive FDI policy, procedural constraints and severe infrastructural deficiencies. During 1991-2000, wide-ranging measures were initiated by the GoI for revamping and restructuring EPZs. This phase was marked by progressive liberalisation of policy provisions and relaxation in the severity of controls and simplification of procedures. Focus had been on delegating powers to zone authorities, providing additional fiscal incentives, simplifying policy provisions and providing greater facilities. In pursuance to these policies and in a major initiative to boost export-led growth based upon Chinese SEZs model, the Indian government replaced the EPZ scheme with the "SEZ scheme".

In 2000, the first SEZ policy in India was drafted and the SEZ Act came up in 2005. The said zones systematically are being projected as "carriers of economic prosperity" that would :

(i) boost economic growth at an extremely fast rate, (ii) usher in affluence in rural areas, (iii) provide large number of jobs in manufacturing and other services, (iv) attract global manufacturing and technological skills, (v) bring in private and public sector investment from both home and abroad, (vi) develop infrastructural facilities, (vii) make Indian firms more competitive, and (viii) help slow down rural-urban migration. In short, they are the officially acclaimed carriers of India's modern industrialization that would create an all round transformation and lead the country towards modern mode of living. A number of state governments in India, irrespective of their political ideology, are vying with each other to woo investors to come into their respective territories for which large-scale concessions and incentives are offered at both state and the central levels. To mention a few :

(i) recognition as duty free zones and foreign territory in terms of trade operations,

(ii) exemption from income, sales or service tax: 100 percent tax exemption for the first five years and 50 percent exemption for the next five years,

(iii) exemption from examination of export/import cargo bycustoms,

(iv) allowance to subcontract to any extent,

(v) freedom from environment impact assessment (EIA) regime,

(vi) allowance to bypass state electricity regulatory commissions and state taxes on raw material,

(vii) exemption from import licence rules, and

(viii) assurance of all basic infrastructure on priority. Section 49 of SEZ Act, 2005 empowers the government to exclude any or all SEZs from the control of any central law.

There and been a tremendous rush to set up SEZs since the Act came into effect in February 2006. The total number of approvals and in-principle approvals across 21 states as on October 27, 2006 was 212 and 152 respectively. As on date 34 SEZs out of these approvals have been notified. Table 1 shows the current status of the upcoming SEZs.

Table 1: Current Status Of Upcoming SEZs

SEZ	Status	Investment	Employment (No)
Nokia, Tamil Nadu:	Commenced commercial production	US$ 100 Million	Direct : 2800 Indirect : 10000
Quark City, Chandigarh: Flextronix in Tamil Nadu	Inaugurated Commences operation in November 2006	$ 0.5 billion FDI* $ 100 million	35000* by May 2007 3000* (2500 under training)
Motorola and Foxconn, Tamil Nadu	Units being set up	$ 200 million*	5000* by December 2007
Apache SEZ (Adidas Group), Andhra Pradesh	Construction started	$ 50 million*	25,000*
Divvy's Labs, Andhra Pradesh	Commenced operations	NA	8000* by April 2007
Rajiv Gandhi Technology Park, Chandigarh	Construction started	NA	5000* by June 2007 (500 under training)
Brandix Apparel SEZ, Andhra Prasesh	Construction started	$ 100 million*	26000* by March 2007

*Source: The Economic Challenger, Issue 33,Oct-Dec'2006 *Expected*

Foreign Players

Interest shown by foreign players has been relatively low, yet a number of big players like Nokia, Apache and Foxcon have already received green signal from the government. Nokia started production in Chennai just in four months of getting approval. It is producing 2.5 million sets every months generating a turnover of Rs. 650 crore in the first four months.

Other foreign players interested in approval for SEZ are Houston-based Hines, one of the largest privately held real estate development, investment and management companies in the world and Semb Corp Engineers and Constructors Singapore.

Posco	Orissa	Steel
Mojashoes	Nellore, AP	Footwar
Sterling	Gujarat	Multi-product
Omaxe Ltd.	Rajasthan	Multi-product
TCG Refineries	West Bengal	Refineries

Source: The Economic Challenger, Issue 33,Oct-Dec'2006

Benefits derived from SEZs:

Benefits derived from SEZs are evident from the investment, employment, exports and infrastructural developments additionally generated. The benefits derived from multiplier effect of the investments and additional economic activity in the SEZs and the employment generated is believed to outweigh the tax exemptions and the losses on account of land acquisition. Stability in fiscal concession is absolutely essential to ensure credibility of Government intensions.

Table 1(a)

Exports From The Functioning SEZs

Year	Value (Rs. Crore)	Growth Rate (over previous year)
2003-2004	13,854	39%
2004-2005	18,314	32%
2005-2006	22,840	25%
2006-2007	34,615	52%
2007-2008	66,638	92%

Source: http://www.sezindia.nic.in

It is evident from the table that SEZ has been instrumental in increasing exports in the country .In 2007-08, exports accounted for 92% of total turnover of SEZs. Over four years (2003-04 to 2007-08), there has been 418% increase in exports.

A look at the investment and employment growth reveals that the ratio of investment to employment was quite high in notified SEZs. Here, the employment created was 1,00,885 whereas investment was Rs. 73,348.00 crore. Contrary to this, Central Govt. SEZs provided employment to relatively more persons (1,99,330) with a lower investment of Rs. 4,043.28 crore.

Table 2

Current Investment And Employment In The SEZs (As On 30 June'08)

	Employment	Investment
Notified SEZs	1,00,885	73,348.00
Private or state Govt SEZs	48,988	3,701.91
Central Govt SEZ	1,99,330	4,043.28
Total	3,49,203	81,093.19

Source: http://www.sezindia.nic.in

Sectorwise Breakup Of Exports From Special Economic Zones:

Sectorwise breakup of Exports (2007-08) from Special Economic Zones in India show that Gems and jewellery, Trade and Service, Computer/Electronic Software and Hardware are the major share of exports in SEZs. Their share was 82.5% out of its total exports. The other export items are textiles. Chemicals, engineering, etc. and these sectors share was 16.5%. Some of the sectors like ceramics, tobacco had minimal share in the total exports.

Table 3

Sectorwise Breakup Of Exports (2007-08) From Special Economic Zones In India

Sectorwise Distribution Of Approved SEZs

Sectorwise Distribution of Approved SEZs indicate that information technology (IT)/ information

	Govt. SEZs	State Govt/Pvt SEZs	Notified under SEZ Act	Total
Biotech			159.45	159.45
Computer/Electronic software	2663.38	1046.24	275.64	3985.26
Electronics hardware	1408.53	6313.34	3399.45	11121.32
Electronics	518.71			518.71
Engineering	886.81	421.87	343	1651.68
Gems and jewellery	15979.98	7025.93	0.15	23006.06
Chemicals & Pharmaceuticals	1069.49	20.33	333.23	1423.05
Handicrafts		30.33		30.33
Plastic and rubber	354.97	302.69		657.66
Leather, footwear and sports goods	190.79		46.23	237.02
Ceramics	24			24
Food and Agro Industry	645.58			645.58
Non-conventional Energy			126.01	126.01
Trading and service	14073.22	6793.75		20866.97
Textiles and garments	1135.69	101.16	79.76	1316.61
Tobacco related products	9.5	8.98		18.48
Misc	314.66	103.23	431.59	849.48
Total	**39275.31**	**22167.85**	**5194.51**	**66637.68**

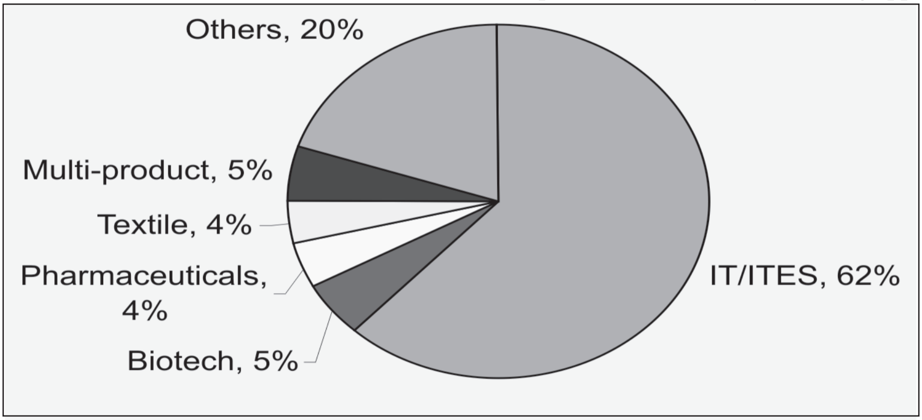
Source: Ministry of Commerce and Industry

technology enabled services (ITES) SEZs accounted for a significant 62% of total approvals. On the other hand, multi-product SEZs, textile, pharmaceuticals and biotech accounted for 5%, 4%, 4% and 5% resp. of the total approvals.

Figure 1

Sectorwise Distribution Of Approved SEZs In India 2008

Most of the SEZs are gigantic, requiring huge land areas (minimum 1,000 hectares for multi-product zones and 100 for the service sector ones). Moreover, the speed with which they are being approved



Source: Government of India,2008

is alarming: 462 formally approved (Fig. 1) till May, 2008 since the enactment of SEZ Act in 2005, comprising about 1,26,077 hectares. Out of these 462, Maharashtra accounts for the largest number (89), followed by Andhra Pradesh (75) and Tamil Nadu (59) .

Statewise Distribution of SEZs

It is found that nearly two-thirds of the approved SEZs are spread over only four states. Ninety two of the 150 SEZs formally approved by the BoA are located in Andhra Pradesh, Maharashtra, Tamil Nadu and Karnataka. In case of in-principal approvals, Haryana, Maharashtra and Karnataka lead the pack of 57 out of the 117 projects. This is to be noted that SEZs approved formally can start operations immediately while those given in-principal nod have to get cleared issues like land acquisition etc. The SEZs formally cleared in Andhra Pradesh, Maharashtra, Karnataka and Gujarat are 27, 26, 19 and 13 respectively, those having in-principal clearance are 4, 19, 15 and 7 respectively.

States which have lagged behind in getting SEZs include Jharkhand, north eastern states and Union territories of Chandigarh, Goa and Pondicherry.

The Central government has decided to give priority to SEZ applications from states which have no or negligible SEZ investments.

Other states which have generated fair amount of interest from SEZ developers include West Bengal with seven formal approvals. The West Bengal government has taken a decision to tread cautiously the path of SEZ approval. Even though the state government is flooded with more than 15 SEZ applications, it has given in-principal approvals to three only - Kolkata Leather Complex, Kulpi and Haldia SEZs. The twin multi-product SEZ proposal by Videocon group is under consideration of the government and may get a green signal once the land is identified for the project. At present only three SEZs are operational in the state namely Manikanchand’s Gems or Jewellery Park, IT SEZ of Wipro and Falta SEZ.

Table4
State-wise Distribution of Approved SEZs in India (May 2008)

A Note Of Caution

State	Appr-oved SEZs (No.)	Total Area in hectares	Percentage share of Major Types					
			IT/ITES	Biotech	Pharmace uticals	Textile	Multi-product	Others
Andhra Pradesh	75	10,825.5	13.18	0.47	6.19	3.73	63.15	13.28
Chandigarh	2	58.45	100.0	-	-	-	-	-
Chhattisgarh	1	10.77	100.0	-	-	-	-	-
Dadra Nagar Haveli	4	1,17.75	11.99	-	-	67.94	-	20.07
Delhi	7	3,86.04	19.38	17.83	31.92	-	-	30.87
Gujarat	39	33,803.2	4.37	0.04	0.17	0.32	48.70	56.40
Haryana	38	16,87.22	34.16	3.49	-	6.80	42.49	13.06
Jharkhand	1	36.00	-	-	-	-	-	100.0
Karnataka	42	27,12.21	39.72	2.70	32.04	8.60	-	16.94
Kerala	1	6,19,1683	31.44	1.94	-	-	-	66.62
Madhya Pradesh	75	547.207	63.23	-	-	-	18.27	18.50
Maharashtra	89	11361.03	12.75	1.91	6.17	7.04	48.73	22.4
Nagaland	2	450.00	-	-	-	-	88.89	11.11
Orissa	9	1953.36	9.58				51.01	39.41
Pondichery	1	346.00	-	-	-	-	100.0	-
Punjab	7	284.07	18.33	-	8.33	35.67	-	35.67
Rajasthan	8	541.10	18.33	-	-	19.11	-	68.56
Tamil Nadu	59	58500.72	58.44	-	-	0.17	3.95	37.44
Uttarakhand	3	468.20	6.10	-	-	-	93.90	-
Uttar Pradesh	26	847.67	37.50	-	-	12.23	12.23	38.04
West Bengal	22	521.52	80.81	1.99	-		-	17.20
India		1,26,077						

Source: GOI,2008

- A careful analysis of the current development patterns in the country will make things clearer. The success stories notwithstanding, the economic contribution of SEZs remained minuscule at the national level. There are different interrelated issues to take note of.

- Though India was the first Asian country to take the free zone initiative and set up the first zone in Kandla as early as in 1965, the share of SEZs in exports was a mere 5 per cent in 2007-08. Furthermore, they accounted for only 1 per cent of factory sector employment and 0.32 per cent of factory investment in the same year. According to Upadhya (2007), providing lucrative employment opportunities for the above workforce contributes only to the reproduction and consolidation of the middle/upper class from whom this workforce is drawn. The total employment that the IT/ITES SEZS will create is negligible and if the number of potential jobs is put against the volume of investment one finds that one job will require an investment of Rs 1 to 1.5 crore or even more [RUPE 2008].

- In 2006-2007 the IT/ITES sector (including engineering services, R&D and software product) accounted for 4.3 per cent of the country's GDP, of which 80 per cent was from exports. But it accounted for only 0.3 per cent of the country's employment. Even of employment in this sector doubles by 2010, it will still account for not more than 6.5 per cent of the country's GDP which will be nine times its share in the workforce [RUPE 2008]. This is in addition to the fact that firms in this sector have strong external but weak domestic linkages, with 75 percent of their output exported.

- Their contribution to regional economies has also been limited. Although they have had a positive impact on regional employment and human development by creating economic opportunities, especially for those without high levels of schooling, their potential in contributing to human development has not been fully exploited due to their failure in attracting investment and promoting economic activities in the regions.

- The sectoral break of SEZ approvals shows that only 5 per cent of the approved SEZs [GOI2008] are multi-product while information technology (IT)/ information technology enabled services (ITES) SEZs are 62 per cent .The manufacturing sector accounts for only one-third of total approvals. This pattern is worrisome. In view of the declining competitiveness of the manufacturing sector, the focus of the SEZ policy needs to be on making India a preferred destination for manufacturing. It is however encouraging to note that the share of manufacturing SEZs in approvals in- principle is 69 per cent. Furthermore, it is instructive to note that SEZs do not embody dynamic forces that can point towards sustainable development. In the long run the competitiveness of SEZs can be sustained only if economy wide investment climate is improved.

- Another aspect of SEZ development is that larger income generated in this sector will mainly boost demand for elite consumption like better housing, automobiles, organized retail, hotels and entertainment, banking and share marker- related activities, etc, that will generate very low domestic employment, even though there may be and addition of some indirect jobs. Its enormous effect on real estate is evident which brings us to the second issue, i.e., the special status that real estate enjoys in contemporary times in the country, in general, and in SEZs, in particular. A major part of the growth envisaged in the SEZs is through real estate and infrastructure. Huge tracts of lands within SEZs are being reserved for real estate projects involving "luxury constructions" that are being projected as infrastructural development. For example, he 5,100 areas of land to be given to the salim group (of Indonesia) in west Bengal where the investors will bring Rs 44,000 crore wil mainly go for making golf courses, hotels, recreation, commerce and world class residential complexes, generating employment to not even 5,000 people [Mitra 2006]. The requirement of surplus capital or profit to regenerate itself through fresh investments, given the coercive laws of competition, is thus met through real estate and/ or "infrastructure development".

- Conversion of farmland into SEZS will clearly aggravete the problems of declining foodgrains availability. Already with a sharp decline in the public investment rates and public development expenditure in the primary sector, the consumption of the poor in the country is sacrificed. The agrarian crisis is getting manifested through a sharp increase in the number of landless rural households (in Kerala, the rise was from 5.8 per cent in 1992 to 3.86 percent in 2002-03) and the large number of farmer suicides underlying which is a steep fall in the profitability of production engineered by neoliberal polices.

- An important caution about SEZ is the nature of the land that is being earmarked for the purpose of establishing SEZs in different states in India.It indicates to a large extent the vulnerability of the rural poor engaged in primary activity. The overall trend in all the states has been to acquire agricultural lands for SEZ activities that are located close to transport lines, highways or other infrastructures. Large tracts of land in agricultural areas in various states (like Maharahtra, Orissa, Punjab, Haryana, Kerala and West Bengal) including multiple cropped lands have been earmarked for the purpose. The above process of acquisition of farmlands for corporate sector, according to Patnaik will facilitate the entry of foreign corporate into agriculture and related activities through contract systems and domestic corporate into urban food retailing by sourcing from agriculture that will aggravate the problem of declining food grains availability and intensify the problem of unemployment among petty traders, in the long run.

- Globally, SEZs have been successful because of their large size and fewer numbers. In India the trend is reverse with huge numbers of applicants and smaller size of SEZs. The Centre should push for five-six large SEZs of 40-50 square miles in coordination with the state Governments. The Central Government should conceptualise these SEZs and arrange private participation and if needed provide capital subsidy too.

The Road Ahead

There should be a vision in the design, establishment and operations of the SEZ.

- It is necessary to develop zones as industrial clusters of specific products. The backward linkages would benefit the growth of accessories units as well.

- The zones should specialise in terms of economic activities depending on the availability of human capital, resources and infrastructure in the region. They thus tend to transform into horizontally-integrated industrial clusters, which include industries that might share a common market for the end products, use a common technology or labor force skills, or require similar natural resources. It seems, therefore, that it would be desirable to develop zones as industrial clusters of specific products. This may encourage downstream industries also.

- Zones in the long run need to give way to industrial clusters of horizontally and vertically integrated industries in general, high tech industries in particular. This would not only help to jump-start the manufacturing processes but would also improve export competitiveness with greater returns.

- At present, there is no autonomous authority responsible for the development of zones and for providing single window clearances in India. The zone administration functions as a government department office. Ideally, the SEZs should be managed by autonomous authorities, which should be constituted under specific Acts and should be assigned the responsibilities to promote the zones.

- In India, SEZs are managed by a single government department. At the zonal level, there is no fine tuning of the division of responsibilities. Ideally, there should be specific departments managing specific issues within SEZs. There should be a general administration department and other departments dedicated to specific issues. For example, there can be an Investor Services department for all the investment processing issues, an Industrial Relations Deparment handling labour issues ,etc.
- Conclusion: The SEZs could drastically improve the economic activity in the country, make the country's export competitive and globally noticeable, be net foreign exchange earner and provide immense employment opportunity. But this should not be done at the cost of bringing down the agricultural activities, Land grabbing and real estate mafia should be properly regulated so that the common man is not the net sufferer to get the net foreign exchange earner up and running. As compared to china where majority of the SEZ's were setup by the government, similar should be adopted in India. There should be a public-private partnership and regulatory bodies should be properly managed to weed out fallacies. To be economically viable SEZ's should be approved over a particular land area (greater than 1000 acres) for rapid economic growth in the area and for it to be profitable and self sustainable. Relaxed Tax norms, Labor laws and DTA regulations will surely attract foreign investment and major industries to setup industries in the SEZ's making it profitable and meeting its desired results.

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