

SEZs

A Reality Check!

Introduction

A Special Economic Zone (SEZ) is a geographical region with economic laws that are more liberal than a country's typical economic laws. SEZs are enclaves with streamlined procedures, tax breaks and good infrastructure.

'SEZ' covers a broad range of more specific zone types, including Free Trade Zones (FTZ), Export Processing Zones (EPZ), Free Zones (FZ), Industrial Estates (IE), Free Ports, Urban Enterprise Zones and others. Usually the goal of an SEZ structure is to increase foreign investment. The economic significance of SEZs is well known world over. Today, there are more than 3,000 SEZs in 120 countries and they account for over US \$ 600 billion in exports and 50 million direct jobs. By offering privileged terms, they attract investments and foreign exchange, spur employment and boost the development of improved technologies and infrastructure. One of the earliest Special Economic Zones was founded by the government of the People's Republic of China (PRC) in the early 1980s. The most successful Special Economic Zone in China, Shenzhen, has

developed from a small village into a city with a population over 10 million within 20 years. Following the Chinese example, Special Economic Zones have been established in several countries, including Brazil, India, Iran, Jordan, Kazakhstan, Pakistan, the Philippines, Poland, Russia, and Ukraine. North Korea has also attempted this to a degree, but failed. Currently, Puno, Peru has been slated to become a "Zona Economica" by its president Alan Garcia. A single SEZ can contain multiple 'specific' zones within its boundaries. The two most prominent examples of this layered approach are Subic Bay in the Philippines and the Aqaba Special Economic Zone in Jordan.

SEZs in India

India was one of the first in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports, with Asia's first EPZ set up in Kandla in 1965. Considering the need to enhance foreign investment and promote exports from the country and realising the



need that a level playing field must be made available to the domestic enterprises and manufacturers to be competitive globally, the Government of India had in April 2000 announced the introduction of Special Economic Zones policy in the country, deemed to be foreign territory for the purposes of trade operations, duties and tariffs.

This policy intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations. SEZs in India functioned from 1.11.2000 to 09.02.2006 under the provisions of the Foreign Trade Policy and fiscal incentives were made effective through the provisions of relevant statutes.

The Special Economic Zones Act, 2005, was passed by Parliament in May, 2005 which received Presidential assent on the 23rd of June, 2005. , the SEZ Act, 2005, supported by SEZ Rules, came into effect on 10th February, 2006, providing for drastic simplification of procedures and for single window clearance on matters relating to central as well as state governments. The main objectives of the SEZ Act are:

- generation of additional economic activity
- promotion of exports of goods and services;
- promotion of investment from domestic and foreign sources;
- creation of employment opportunities;
- development of infrastructure facilities;

The Ministry of Commerce aims to attract investment of about Rs 1,00,000 crore including FDI of Rs 25,000 crore and create additional 5,00,000 direct jobs through these Zones.

Incentives and facilities offered to the SEZs

The incentives and facilities offered to the units for attracting investments into the SEZs include:-

- Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units.
- 100% Income Tax exemption on export income for SEZ units under Section 10AA of the Income Tax Act for first 5 years, 50% for next 5 years thereafter and 50% of the ploughed back export profit for next 5 years.
- Exemption from minimum alternate tax under section 115JB of the Income Tax Act.
- External commercial borrowing by SEZ units upto US \$ 500 million in a year without any maturity restriction through recognized banking channels.
- Exemption from Central Sales Tax.

- Exemption from Service Tax.
- Single window clearance for Central and State level approvals.
- Exemption from State sales tax and other levies as extended by the respective State Governments.

The major incentives and facilities available to SEZ developers are:-

- Exemption from customs/excise duties for development of SEZs for authorized operations approved by the BOA.
- Income Tax exemption on income derived from the business of development of the SEZ in a block of 10 years in 15 years under Section 80-IAB of the Income Tax Act.
- Exemption from minimum alternate tax under Section 115 JB of the Income Tax Act.
- Exemption from dividend distribution tax under Section 115O of the Income Tax Act.
- Exemption from Central Sales Tax (CST).
- Exemption from Service Tax (Section 7, 26 and Second Schedule of the SEZ Act).

SEZ Approval Status

In the twenty-five meetings of the Board of Approvals (BoA) held since the SEZ Rules came into effect on 10th February, 2006, formal approval has been granted to 462 SEZ proposals. There are 135 valid in-principle approvals. Out of the 462 formal approvals, 222 SEZs have been notified.

Land requirements for approved Special Economic Zones

Land requirement for the formal approvals granted till date is approximately 64222 hectares. State Industrial Development Corporations/State Government Ventures, with 101 approvals, account for over 20453 hectares. In these cases, the land already available with the State Governments or SIDCs or with private companies has been utilized for setting up SEZ. Land for the 222 notified SEZs where operations have since commenced is approximately 28447 hectares.

Out of total land area of 2973190 sq km in India, agricultural land is of the order of 1620388 sq km (54.5%). Land in possession of 222 notified SEZs is about 284 sq km. Land required for formal approvals granted works out to 642 sq km approximately.

Employment generation

Out of the 462 formal approvals given till date, 159 approvals are for sector specific and multi product SEZs for manufacture of Textiles and Apparels, Leather

SEZs: Statewise Distribution				Formal
State	Formal approvals	In-principle approvals	SEZs	
Andhra Pradesh	75	3	54	
Chandigarh	2		2	
Chattisgarh	1	2		
Delhi	2			
Dadra & Nagar Haveli	4			
Goa	7		3	
Gujarat	39	9	19	
Haryana	38	17	18	
Himachal Pradesh		2		
Jharkhand	1		1	
Karnataka	42	9	20	
Kerala	12	1	8	
Madhya Pradesh	13	5	3	
Maharashtra	89	37	27	
Nagaland	2			
Orissa	9	4	4	
Pondicherry	1			
Punjab	7	8	2	
Rajasthan	8	9	4	
Tamil Nadu	59	12	40	
Uttar Pradesh	26	4	10	
Uttaranchal	3	-	1	
West Bengal	22	13	6	
GRAND TOTAL	462	135	222	

Footwear, Automobile components, Engineering etc. Nokia and Flextronics electronics hardware SEZs in Sriperumbudur are providing employment to 13623 and 1272 persons, majority of whom are women. Hyderabad Gems SEZ for Jewellery manufacturing in Hyderabad has employed 2000 persons of which 1175 are women. Apache SEZ in Andhra Pradesh currently employs 4750. In the services sector, IT/ITES SEZs are projected to take 12.5 million sq meters' space which, as per NASSCOM standards, translates into 12.5 lakh jobs.

Direct employment in Special Economic Zones (as of 31.3.2008)

Total employment in SEZs : 3,36,235 persons
 Total incremental employment generated in SEZs since Feb., 2006 : 2,01,531 persons
 Break up:
 In addition to this, current Indirect employment

(construction workers/labourers etc.) in the newly notified SEZs is of the order of 2,20,506 persons.

Exports from the functioning SEZs in the last 5 years

Private investment in Special Economic Zones (as of 31.3.2008)

Total investment in Special Economic Zones as of 31.3.2008 : Rs 77210 crore

Incremental investment since February, 2006

Thus far:

In more than a decade of opening of India, the Special Economic Zone (SEZ), probably, has become the most controversial economic reforms announced in recent time. The earliest critics bemoaned that Indian SEZs, with their size much smaller than those in China, would never attain economy of scale and hence, were doomed. Detractors then focused

Direct Employment created in notified SEZs (as of 31.3.08.)	97993 persons (all Incremental Employment generated after February 2006)
Direct Employment in Private/State Govt. SEZs which came into force prior to SEZ Act, 2005 (as of 31.3.08.)	44768 persons (Incremental employment generated since Feb. 2006: 32,300 persons)
Direct Employment in 7 SEZs established by the Central Government (as of 31.3.08.)	1,93,474 persons (Incremental employment generated since Feb. 2006: 71,238 persons)

Investment in notified SEZs (as of 31.3.08.)	Rs 69350 crore (all Incremental investment generated after February 2006)
Investment in Private/State Govt. SEZs which came into force prior to SEZ Act, 2005 (as of 31.3.08.)	Rs 3960.44 crore (incremental investment generated since Feb 2006 is Rs 2204.13 crore)
Investment in 7 SEZs established by the Central Government (as of 31.3.08.)	Rs 3899.49 crore (incremental investment generated since Feb 2006 is Rs 1620.29 crore)

Year	Value of Physical Exports from SEZs (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%

attention on issues like tax breaks and diversion of investment to avail them. Then came concerns about real estate scam. Finally, the turning point came when farmers went on a rampage in Singur and Nandigram, claiming that acquisition of their farm land for an industrial project (Singur is not an SEZ though) would leave them impoverished. Serious discourses on models of development, displacement and rehabilitation, employment generation, foreign investment, primacy of industry over agriculture are being advanced both for and against SEZs.

The confusing signs emerging within the government departments have misled people from both the sides resulting in violent protest and clash. While the Commerce Ministry expects the zones to draw nearly 600 billion rupees (\$13.5 billion) in investment by 2009 and create 890,000 (direct and indirect) jobs, an internal assessment of the Finance Ministry has estimated that by 2010 the country will forgo about Rs 1,60,000 crores in direct and indirect taxes because of the SEZs across the country. Government of India wants to follow China way but while in China there are only six SEZs, in India the number of SEZs is in hundreds.

Political intervention halted further SEZ approvals for some months. Now, with the decision taken by the Empowered Group of Ministers (EgoM), SEZ size is now capped at 5,000 hectares and State Governments can set even lower ceilings. While the Government's concern about welfare of farmers is understandable, the logic of blanket cap on SEZ size is misplaced. The EGoM has also stipulated that State Governments must not acquire land for SEZs and that SEZ developers would have to directly negotiate with land owners. The restriction on size defeats one of the stated objectives of the SEZ Policy - to boost development of infrastructure facilities. It will be counterproductive to building new industrial and social infrastructure viz. industrial towns on a cost efficient basis.

There is a view that the SEZ system would discriminate against industries in other areas. These are alarmist views, largely unfounded as enough safeguards have been put in the policy. The Development Commissioner (DC), a central government employee, has the right to approve every activity in the zone and to address grievances of units.

Land acquisition for industrial projects has always been a daunting task and given past experience, without the State Government's intervention, it would be impossible to do any large land acquisition. The government could restrict its role to intervening only for isolated pockets in order to bring about contiguity, which is an important aspect for approval of SEZs.

A fair and just rehabilitation and compensation policy for all acquisitions of land, not just SEZs but all projects, should be put in place. A proper compensation implies at least compensations for lost home, lost assets, lost professions and lost regular income. Thus, those who have lost home and land must receive a new home or apartment, value of the land taking into account the possible appreciations over the foreseeable future and a new job or regular monthly payments to compensate for the loss of income. A further provision must be made for lost education for the children of the farmers.

There is a second argument as well from the point of view of overall economic policy. Industrialization just for the sake of it is not justified. It is essential to look at the costs and benefits of setting up an industry. In Singur for example, it is reported that about 14,000 families are being evicted from about 1000 acres of land. Out of those nearly 12300 persons are landowners; the rests are landless tillers. Assuming only one person per family was gainfully employed in farming, the number of job losses are 14,000 minus those who are not dependent on farming for living. However, only about 4000 people may be employed in the main plant with a further 2000 in ancillaries and service sector. The number of job-losses would be huge. Thus, there is a net welfare loss in terms of net job destructions which needs to be addressed.

The administrative reforms commission has called for fewer special economic zones (SEZs), shorter tax holidays and sought a relook into the SEZ Act saying that the establishment of SEZs has become a source of conflict frequently leading to violence. The commission proposes income-sharing strategy

to compensate oustees from SEZs to make them primary stakeholder partners rather than one-time beneficiaries or spectators of the SEZ development. It also wants reconsideration of the “extremely liberal tax holidays provided both for export units and to developers” The latest report, which deals with conflict resolution, identifies the SEZ policy and the consequent displacement, loss of agricultural land and the potential for real estate speculation as an area of conflict.

It also notes that all the negative points in the Chinese SEZ policy that led to negative consequences have been included in the Indian policy. “It is, therefore, necessary to be vigilant about the social costs and consequences of the SEZ policy since it may lead to conflicts,” it adds. It seconds the recommendation of the group of ministers on SEZs that the state governments should not normally acquire the bulk of the lands for the SEZs. The commission says that a better approach would be to have a limited number of SEZs preferably in backward areas so that they lead to infrastructure creation. It also says that the proportion of land allowed to be used for non-processing activities should be minimised.

The commission notes that the rehabilitation packages unveiled by the SEZs are far from satisfactory and the formula of the group of ministers that at least a person in the family is given a job is not adequate. The commission also says that the SEZs should specify establishment of vocational training centres and provision of water, sanitation and health facilities in the vicinity should precede SEZ development.

Noting that a scramble has been generated among developers to grab cheap agricultural land in order to make quick profits or evade taxes, the commission says that to prevent conflict situations, industrial activities and SEZs should be located in areas where least displacement is caused and do not usurp agricultural lands. For the purpose, the commission says that comprehensive land use plans should be prepared which indicate where industrial activities and SEZs should be located. These plans, it adds, should be finalised after public consultations.

Distribution of SEZs

The eight States of Andhra Pradesh, Gujarat, Haryana, Karnataka, Maharashtra, Tamil Nadu, Uttar Pradesh and West Bengal account for nearly 94 % of Formal Approvals and 87% of Notified SEZs. Approvals of SEZs from remaining 20 odd States and Union Territories is just 6%. Most of these 8 States are industrialized and on high growth trajectory. Therefore, SEZs will accentuate the gap between high growth and low growth states instead of bridging it. In Karnataka and West Bengal, more than 50% of the SEZs approved will be located in Capital cities

Bangalore and Kolkatta respectively. Likewise there is concentration of the Zones around Faridabad / Gurgaon in Haryana and Noida in Uttar Pradesh. The purpose of SEZ as a vehicle of all-round development of the State and decongesting the Capital city is defeated. In Andhra Pradesh, Gujarat, Maharashtra and Tamil Nadu, the approved SEZs are distributed all over the State.

One of the objectives of the SEZ scheme is to break the impasse of job less growth by inducting large manufacturing units with high job potential. Two thirds of the SEZs notified are in the IT/ITES space. There are very few engineering zones with good employment potential. Majority of the local, displaced, farmers are not equipped to take up jobs in the IT / ITES industry which can result in bitterness and frustration.

Conclusion

Human rights groups are outraged by the large-scale displacements and loss of livelihoods that the SEZs will cause. They also criticise the government for giving generous fiscal incentives to industry while cutting subsidies on food. They contend that conversion of land to SEZ would mean destruction of groundwater recharge systems, contamination by release of industrial effluent and crisis of water for the neighbouring communities.”

Despite controversy, despite opposition and despite unresolved policy / regulatory issues, special economic zones (SEZs) continue to make progress. The picture is not all rosy. In states like Goa, the opposition to SEZs is very strong, which is impeding the process of development. Land acquisition is getting more difficult and costlier by the day. Even though the SEZ legislation calls for single-window clearance system, in practice, multiple clearances are required. No step has been taken to make the labour laws less stringent for SEZ units. The RBI treats SEZs as real estate, rather than infrastructure which affects bank lending to such projects.

The world over, the majority of successful SEZs have been built with government capital, like Dubai Jebel Ali Free Zone and China’s successful SEZs. Special Economic Zones (SEZs) are great for countries seeking to attract investments, promote trade and industry and create jobs. The global successful SEZs do not make much profits and their return on investment is very poor. Some of the successful SEZs, capitalized with government money have written off their initial investment before they have been handed over to the private corporate bodies.

In India, the private sector is euphoric about investing in SEZs but private capital comes with a cost. It remains to be seen as to how many SEZs would generate decent return on investment.

The present value of the fiscal cost of SEZs is thrice the infrastructure generated, and there is little to suggest

this will result in a net addition to overall investment in the country. The possible impact of this policy on the economy is hotly debated. The fiscal impact is contingent on whether the investment is incremental over and above the existing levels of investment or whether it is just realignment. If investment would not have occurred in absence of policy, there can be no revenue loss attributed to policy. Revenue loss arises only if the investment is a re-alignment of normal investment levels in the country.

SEZ in itself is not a bad idea, what is important is the proper policy of land selection, acquisition, compensation. Destroying prime agricultural plots for the sake of industrialization doesn't necessarily result in equitable development, as farmers don't make an easy transition for the jobs that are offered in SEZs. Equally important is to closely monitor the activities of SEZs to find out whether they are really contributing for the growth as originally conceptualized or have become simply the real estate brokers.

There is a fair degree of support as State governments are collaborating with the Union Ministry for promotion of SEZs. The jewellery

industry in Mumbai aptly describes how SEZ can contribute to the development of economy. In 1987-88, "wax setting technique" was introduced for the first time in jewellery production.

Overnight, the cottage industry was transformed into a mechanized modern industry with the SEZs accounting for 55% of the total Indian jewellery. As it is, the availability of low cost labour makes India a very lucrative destination for investors. with various tax benefits also on the anvil, the benefits of SEZ are there for everyone to avail of.

SEZ cannot be in existence for perpetuity. It must be judiciously employed to kick start economic activity in the absence of good infrastructure. The fiscal cost precludes deployment of the scheme across large tracts of industrial and commercial activity. With good infrastructure and governance, SEZ should be made redundant.



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