

Special economic zones in India: A tool for economic development

Barkha Jamwal

Assistant Professor, College of Vocational Studies, University of Delhi, Delhi, India

Abstract

The Special Economic Zones (SEZs) are considered to be the drivers of growth for an economy. It is considered a tool for growth, development, rising exports and employment generation. It is an instrument that attracts Foreign Direct Investment (FDI) into the economy. The role of policy makers is considered to be the most important to make sure that all these objectives of SEZs are achieved. The government has provided various incentives in the form of single window clearance mechanism to reduce the bureaucratic delays, tax concessions, providing land at cheaper rates, duty free import of materials, 100% FDI via automatic route except for some items, exemption from Minimum Alternate Tax, the benefit of external commercial borrowings up to a certain limit etc. There is a need to develop sustainably so that the future of the economy is not endangered.

Keywords: SEZs, FDI, single window clearance, minimum alternate tax, external commercial borrowings, sustainable development

Objective of the study

The paper aims to study the history, role of Special Economic Zones in India and how it attracts Foreign Direct Investment. The paper also throws a light on the SEZ policy followed by China and what we can learn from them. The SEZs and Sustainable Development is also discussed at the end of this paper.

Research Methodology

The secondary data from various journals, newspaper articles and government sites is taken for the research purpose.

Introduction and history

Special Economic Zones (SEZs) are the localities that offer incentives in the form of lower tax, cheaper land etc. to their resident businesses. India's SEZs are relatively new; still these now form a very important part of manufacturing and sourcing destination. If we look back into the history of SEZs in India then it can be seen that till 2000, India did not have any SEZs but instead had export processing zones (EPZs) in number. EPZs are quite similar to SEZs but they still failed to attract the firms to India. With Asia's first Export Processing Zone (EPZ) in Kandla in 1965, India was first to recognize the effectiveness of the EPZ model in development of the nation and promoting exports. But soon the Special Economic Zones (SEZs) policy was announced in April 2000 to overcome the flaws related to absence of world class infrastructure, rigid and multiple rules & regulations, and an unstable fiscal regime focusing on attracting higher foreign investments into India. The government's SEZs policy in April 2000 was based on the Chinese structure of SEZs which is already a success. They were built and designed to stimulate the domestic and foreign investment, boost India's exports and create new employment and investment opportunities. The SEZ Act 2005 in India further converted its EPZs to SEZs and amended the country's foreign investment policy. (india-briefing.com, 2014) ^[15]

A comprehensive draft SEZ Bill was prepared after detailed discussions with the stakeholders which focused on stable SEZ policy regime thereby generating more economic activity and employment in the economy. Around 800 suggestions and recommendations were received on SEZ draft rules and after extensive consultations, the SEZ Act, 2005 along with SEZ Rules came into effect on February, 2006 which provided simplification of procedures and single window clearances on state and central government related matters.

The main goals of the SEZ Act are:

- Generating additional economic activity
- Promoting exports of goods and services;
- Promoting investment from domestic and foreign sources;
- Creating employment opportunities;
- Developing infrastructure facilities. (sezindia.nic.in)

The SEZs are specially designed duty free areas considered to be a deemed foreign territory (within India) for the purpose of operations, trade, duty and tariff. These zones have their own infrastructure, support services, are self-contained and are governed by economic laws that are different from country's general economic laws that facilitate trade, employment and investment.

The SEZ area can be divided into Processing and Non Processing Areas:

- The Processing Area is the one in which core business activities of SEZs takes place. At least 50% of the SEZ area must be processing area.
- Non Processing Area is where the support infrastructure is created which mainly caters to the needs of the employees working in SEZ.
- Developer/Co-developer is the one who establishes the entire SEZ. There can be more than one Co-developer(s). Generally, the infrastructure in the non-processing area is developed by them.
- Entrepreneur is the one who sets up the units in SEZ. (www.mondaq.com)

Currently India has one of the largest numbers of SEZs in the world. As of May 2015, 437 SEZs have been approved under SEZ Act. During the same period there were 348 notified and 202 operational SEZs. There is a direct impact of setting up of SEZs on employment and exports. As per Statistics provided by Export Promotion Council for EOUs and SEZs as of 31st March 2015 the SEZs have attracted investments worth Rs. 3,387.94 billion and have generated direct employment for more than 1.44 million people. Also in the year 2014-15, exports worth Rs4637.7 billion were made from SEZs. The SEZ in India may be set up by the public, private, joint sector or by state government. Within these zones, units may be set up for manufacturing goods, providing services, and/or other activities related to trading, repairing, processing, assembling, making of gold/silver, platinum jewellery etc. the SEZ policy also allows 100% FDI in most of the manufacturing activities. (Mukherjee, Pal, Deb, Ray, & Goyal)

Currently the SEZs are operating throughout India in the states of Chandigarh, Haryana, Rajasthan, Karnataka, Gujarat, Kerala, Orissa, Tamil Nadu, Maharashtra, West Bengal, Uttar Pradesh etc.

Names of the few SEZs set up by the Central Government of India are:

- Falta Special Economic Zone, Falta (West Bengal)
- SEEPZ Special Economic Zone, Mumbai
- Visakhapatnam Special Economic Zone, Vishakhapatnam (AP)
- Noida Special Economic Zone, Noida (UP)
- MEPZ Special Economic Zone, Chennai (TN)
- Kandla Special Economic Zone, Kandla (Gujarat)
- Cochin Special Economic Zone, Cochin (Kerala) (investindia.gov.in)

Incentives and facilities offered to the SEZs

- **Customs and Excise:** SEZ units may import or procure from the domestic sources, at a duty free rate, all their requirements of spares, raw materials, consumables, packing materials, capital goods, office equipment, etc. for implementation of their project in the Zone without any licence or specific approval. They can use duty free import/domestic procurement of goods for setting up of SEZ units. Also Domestic sales by SEZ units will now be exempt from Special Additional Duty.
- **Income tax:** There is 100% Income Tax exemption on export income of SEZ units under section 10AA of the Income Tax Act for the first five years, 50% exemption for the next five years and 50% of the ploughed back export profit for the next five years. Also there is exemption from Minimum Alternate Tax under section 115 JB of the IT Act. The SEZ units can avail benefit of External Commercial Borrowing for up to USD 500 million in a year without any maturity restriction. There is Exemption from dividend distribution tax for the SEZ developers under Section 115O of the Income Tax Act.
- **Foreign Direct Investment:** 100% FDI is allowed under automatic route in manufacturing sector in SEZ except items related to arms and ammunition, atomic substances, explosives, narcotics and hazardous chemicals, cigars and tobacco substitutes, distillation and making of alcoholic drinks and cigarettes.

- **Banking/Insurance/External Commercial Borrowings:** The Off-shore Banking Units (OBUs) can be set up in SEZs. These OBUs are allowed 100% Income Tax exemption on profit for 3 years and 50 % exemption for the next two years. There is flexibility to keep 100% of export proceeds in EEFC (Exchange Earners' Foreign Currency) accounts and there is freedom to make overseas investment from such account. There is exemption from interest rate surcharge on import finance. Also, SEZ units are allowed to write-off unrealised export bills.
- **Environment:** SEZs are permitted to operate as non-polluting industries in IT and in facilities like golf courses, hotels and non-polluting service industries in the Coastal Regulation Zone area
- **Central Sales Tax and Service Tax:** There is exemption from Central Sales tax for the sales made from Domestic Tariff Area to SEZ units. Also, there is exemption from Service tax to SEZ units. (sezindia.nic.in)

Do SEZs Attract FDI?

Some of the countries like China, India and Brazil could attract higher FDI, whereas other developing countries could not do so. India, along with China has been among the top 10 in the list of FDI recipients in the last 20 years and the quantum of FDI inflows into India has increased manifold in the post reform period. Studies have shown that FDI inflows are concentrated in few states on India i.e. Maharashtra, Delhi, Karnataka, Tamil Nadu, Andhra Pradesh and Tamil Nadu which have contributed 70% of total FDI inflows during 2008-09 to 2011-12. Among these Maharashtra and Delhi together contributed more than 50% of FDI inflows. It has been noticed that infrastructure plays an important role in attracting FDI and this is the reason why most of the SEZs in India are located in cities or areas where the facilities like airport connectivity, well connected roads, seaport are available. The countries have facilitated power supply, rebate on profits, tax holidays, land availability at concessional rates in order to attract FDI. It cannot be said that the states having high socio-economic index, human development index or good life expectancy ratio will surely attract higher FDI as is the case with Kerala. The states like Odisha in India have high FDI inflows even though its HDI, Socio-economic index is not that high. This is because of the proactive reforms initiated by some of the states that such states and areas attract higher FDI as compared to others. As per studies conducted by researchers it has been validated that SEZ policy has a direct impact on FDI inflows in a state. Besides SEZ policy formulation, other factors that influence FDI inflows are urbanization, access to seaport, road infrastructure. It was seen that highway density had a negative impact on FDI inflows may be because even a simple road which is not a highway can be termed as a good infrastructure that facilitates trade. (Chakraborty, Gundimeda, & Kathuria, 2017) ^[1]

SEZs and their role in economic development

Initially the SEZs were formed to boost the development and growth of the manufacturing sector but with time and rapid changes in business environment the emphasis shifted to service sector. The two most important reasons for setting up SEZs are to (1) promote trade and competitiveness and (2) to attract FDI, technology and global best practices. Often, SEZs

act as experiment grounds for the application of the new policies before they are applied at national level. The SEZs can even attain benefits due to clustering and can achieve economies of scale and efficiency. Some of the benefits can even spill over to the industries in Domestic Tariff Areas through their inter-linkages. The domestic economy even benefits from direct and indirect employment that is created due to business activities taking place in these SEZs.

The evidence shows that SEZs play a more important role in developing economies like India and China. SEZs have not been a universal success model. Few countries like China, has encountered the majority of employment and exports that are generated by SEZs. Many countries like Africa have witnessed the failure of SEZs as these have failed to generate any

significant economic activity in these areas. Whereas approx. 80% of the total FDI inflows are from SEZs and similar free trade zones in China, no other country has encountered such a tremendous rise and growth due to SEZs. Hence the diverse, mixed and vast experience of countries regarding the SEZs performance shows that SEZs do not guarantee the benefits in the country where it has been formed. These need to be supported with the right policies, laws and regulations, ease of doing business, transparent and easy to follow policies which need to be amended from time to time to suit the economic conditions of the country. Also there need to be effective linkage between the SEZ and rest of the economy to get the maximum benefit out of establishment of SEZs. (Mukherjee, Pal, Deb, Ray, & Goyal).

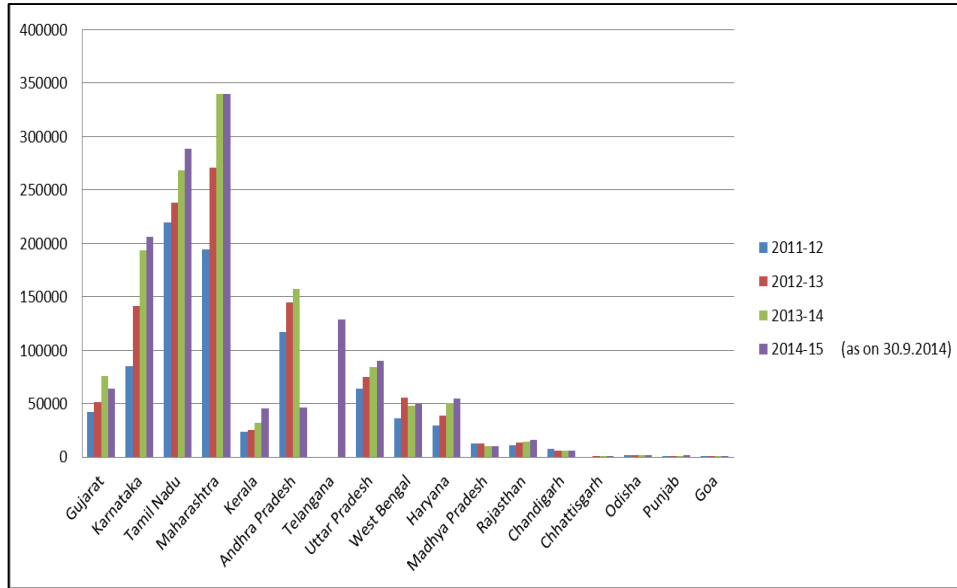
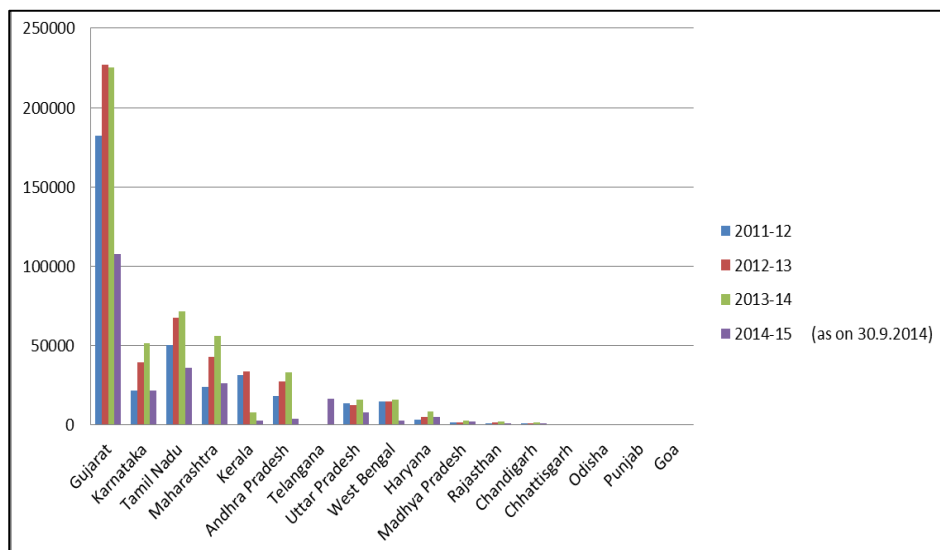


Fig 1: States/Uts-wise details of contribution to Employment from SEZs during 2011-15

The above figure shows that States like Maharashtra and Tamil Nadu have been contributing the most to employment generation from SEZs. Out of total number of employed persons in 2014-2015 (as on 30-9-2014) i.e. 1,350,071,

Maharashtra employed 340,061 persons which is 25% of the total number of persons employed from the units in SEZs. (pib.nic.in)



(pib.nic.in) Figures in rupees crore.

Fig 1: States/Uts-wise details of contribution of Exports from SEZs during 2011-15

Over the years it can be seen that Gujarat has been contributing the most to the exports from SEZs.

What Can Be Learnt From China

The first ever SEZ was established in China in 1980 in Shenzhen. Since then SEZs have been contributing to rising exports and have been the main driver of growth of the economy. The main motive of introducing SEZs in China was that SEZs served as an experiment ground for market based policies and reforms for implementing them with land, labour and tax policies. Also China's SEZ policy is linked with macroeconomic policy of nation whose primary objective is to attract FDI in a closed economy and to inject seed money for modernization. This enabled China to test the success of these laws and policies which then could be implemented in the whole country if found successful. India did not use SEZs to test reforms or to liberalize the FDI regime which if successful could be applied to rest of the country.

SEZs and Sustainable Development

The aim of sustainable development is to make sure that growth of economy takes place without causing any adverse impact on the environment. SEZ policy can help an economy to achieve the growth objective in short run but in long run even the units in SEZs will be profitable if they grow keeping in mind the adverse impact of its effluents on the environment. Since nowadays government is focusing on reducing its deficit by increasing the quantum of exports and wants to increase the standard of living of people by generating employment opportunities, it is providing incentives and facilities to companies who set up their operations in SEZs. The policy makers need to keep in mind the long term impact of such development and hence frame the policies accordingly. The Centre and State governments also aims to develop the rural areas by providing adequate infrastructure to these areas and then setting up SEZs there. With this the standard of living of such rural area improves as there are now employment opportunities available for the local people to get into. The government should also encourage development of Micro, Small and Medium Enterprises in Special Economic Zones as a testing ground which if successful can be transformed into a large business.

Conclusion and Suggestions

SEZs have been contributing to Nation in terms of rising exports and employment from this sector. It's even contributing to regions in terms of income generation and promotion of ancillary industrial activities and is boosting up the technology transfer and development of entrepreneurship locally. It is even expected that SEZs will further activate a substantial flow of domestic and foreign investments into India leading to more employment opportunities and generating additional economic activities. Also, since SEZs help in development of regions as a whole hence it is expected that SEZs might attract migrant rural population and boost the demand for commercial and housing real estate. (investindia.gov.in) The most important factors that help in attracting FDI in SEZs are the FDI policies of the nation, the macro-economic policies, market, infrastructure, resources in the economy, the role of private sector, and the policies formed by the state on trade and industry. On the basis of all these factors some of the suggestions that can be made are: the

policy makers and top officials of SEZs must provide an enabling environment to the businesses so that they can operate and carry on their business activities easily and smoothly. There must be a single window clearance mechanism to be followed to improve the quality of bureaucracy and to eliminate unnecessary administrative barriers that cause delays and hinder growth. Strengthening of infrastructure including roads, airports, water supply, electricity etc. which attracts the foreign firms to invest in India should also be the priority. The human resource must from time to time be given adequate training to make sure they are ready to handle complex situations in the business. Efficient competitive environment for domestic firms should be provided to compete with foreign players. (Karimi, Sofiyabadi, Niroumand, & Karimi, 2013) ^[2]

Reference

1. Chakraborty T, Gundimeda H, Kathuria V. Have the Special Economic Zones Succeeded in Attracting FDI?— Analysis for India. *Theoretical Economics Letters*, 2017, 623-642.
2. Karimi A, Sofiyabadi J, Niroumand P, Karimi M. Ranking the Factors to Attract Foreign Direct Investment in Special Economic Zones. *European Journal of Scientific Research*. 2013.
3. *India-briefing.com*. (2014, Oct). Retrieved from <http://www.india-briefing.com/news/guide-indias-special-economic-zones-9162.html/>
4. *Investindia.gov.in*. (n.d.). Retrieved from <http://www.investindia.gov.in/sezs-sector/>
5. (n.d.). Special economic Zones in India: Status, Issues and Potential. In A. Mukherjee, P. Pal, S. Deb, S. Ray, & T. M. Goyal. Springer.
6. *pib.nic.in*. (n.d.). Retrieved from <http://pib.nic.in/newsite/PrintRelease.aspx?relid=112106>
7. *sezindia.nic.in*. (n.d.). Retrieved from <http://sezindia.nic.in/about-introduction.asp>
8. *www.mondaq.com*. (n.d.). Retrieved from <http://www.mondaq.com/india/x/303448/Inward+Foreign+Investment/Special+Economic+Zones+Reinforcing+Investors+Interest>