SPECIAL ECONOMIC ZONES - AN INDIAN PERSPECTIVE

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Abstract

Most developing countries like India across the world have recognized the importance of facilitating international trade for the sustained growth of the economy and increased contribution to the GDP of the nation. To instill confidence in domestic as well as foreign investors and signal the Government's commitment to a stable SEZ policy, The Special Economic Zones Act, 2005, was passed by Parliament in May, 2005 which received Presidential assent on the 23rd of June, 2005 and came into effect on 10th February, 2006.In India formal approval has been granted to 579 SEZ proposals. There are 147 valid in-principle approvals. Out of the 579 formal approvals, 335 SEZs (out of 579) + (7 Central Govt. + 12 State/Pvt. SEZs) have been notified as on 8th September 2009. In Indian economy 98 SEZ's are functional in different states as on 4th August 2009. Up to 30th June, 2009, Total 2,301 units have been approved in various SEZs comprising 1201 units in Govt. SEZs; 600 units under State/Pvt. SEZs; and 500 units under the SEZ Act 2006, With total investment of Rs.1,14,640.53 cr and providing employment to 3,87,439 persons. In the year of 2008-09 the volume of total exports from SEZs were of Rs.99,689 with 92% incremental growth from the previous year i.e. 2007-08. These achievements speak itself about the efficacy of SEZ in India. Keeping the government's goal of attracting $150 billion of FDI in mind, the Investment Commission chaired by Ratan Tata has asked the government to provide labour flexibility, remove or reduce restrictions on sectoral caps as well as promote SEZs for key sectors in order to boost investments in the country.

INTRODUCTION

An SEZ is a trade capacity development tool, with the goal to promote rapid economic growth by using tax and business incentives to attract foreign investment and technology. An "SEZ" can also be identified as a geographical region which has more liberal economic laws than a country's typical economic laws. Today, there are approximately 3,000 SEZs operating in 120 countries, which account for over US$ 600 billion in exports and about 50 million jobs. By offering privileged terms, SEZs attract investment and foreign exchange, spur employment and boost the development of improved technologies and infrastructure.

The present paper proposes to dwell upon the following points:

1. SEZ meaning, importance and Endeavour in India
2. Incentives and facilities offered to SEZ developers and units in SEZ, in Indian Economy

3. Efficacy of Special Economic Zones Act, 2005 in Indian economy- current status and incremental growth of investments, employment and exports in functional SEZs in India
4. Impediments and suggested measures to extract the better results.

Most developing countries like India across the world have recognized the importance of facilitating international trade for the sustained growth of the economy and increased contribution to the GDP of the nation. As a part of its continuing commitment to liberalization and to trigger larger flow of foreign and domestic investment for the generation of additional economic activity and creation of employment opportunities, government of India started promoting SEZs. India was one of the first in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports. Asia's first EPZ set up in Kandla in 1965. EPZ's could not prove their efficacy in Indian economy and so could not attract larger foreign investments. Therefore, due to the shortcomings experienced on account of the multiplicity of controls and clearances; absence of world-class infrastructure, and an unstable fiscal regime, the Special Economic Zones (SEZs) Policy was announced in April 2000. 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.

To instill confidence in domestic as well as foreign investors and signal the Government's commitment to a stable SEZ policy, extensive discussions with the stakeholders were held to evolve a comprehensive draft of SEZ Bill 2005. A number of meetings were held in various parts of the country both by the Minister for Commerce and Industry as well as senior officials for this purpose. And thereafter, the Ministry of Commerce and Industry laid down the regulations that govern the setting up and administering of the SEZs. State Governments play a significant lead role in the development of SEZs in their respective States by stipulating the conditions to be adhered to by an SEZ and granting the necessary approvals. The policy framework for SEZs has been enacted in the SEZ Act and the supporting procedures are laid down in SEZ Rules.
The Special Economic Zones Act, 2005, was passed by Parliament in May, 2005 which received Presidential assent on the 23rd of June, 2005. After extensive consultations, 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 Special Economic Zones Act, 2005 was developed to overcome the shortcomings of existing statutes governing the SEZ's in India and to simplify the procedures for development, operation,

and maintenance of the Special Economic Zones and for setting up units and conducting business in SEZs.

The SEZ Rules provide for:

- Simplified procedures
- Single window clearance for setting up of an SEZ;
- Single window clearance for setting up a unit in a Special Economic Zone;
- Single Window clearance on matters relating to Central as well as State Governments;
- Simplified compliance procedures and documentation with an emphasis on self certification.

Incentives and Facilities Offered To The Sezs In Indian Economy

The incentives and facilities offered to the units in SEZs for attracting investments into the SEZs, including foreign investment 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** include:-
- 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).

Efficacy of Special Economic Zones Act, 2005

Current Status of SEZ's in India speaks itself about the results produced. Consequent upon the SEZ Rules coming into effect w.e.f. 10th February, 2006, Twenty-eight meetings of the Board of Approvals have since been held. During these meetings, formal approval has been granted to 579 SEZ proposals. There are 147 valid in-principle approvals. Out of the 579 formal approvals, 335 SEZs (out of 579) + (7 Central Govt. + 12 State/Pvt. SEZs) have been notified as on 8th September 2009. In Indian economy 98 SEZ's are functional in different states as on 4th August 2009. Up to 30th June, 2009, Total 2,301 units have been approved in various SEZs comprising 1201 units in Govt. SEZs; 600 units under State/Pvt. SEZs; and 500 units under the SEZ Act 2006.

Benefit derived from SEZs is evident from the investment, employment, exports and infrastructural developments additionally generated in Indian economy. The benefits derived from multiplier effect of the investments and additional economic activity in the SEZs and the employment generated thus has far outweighed the tax exemptions and the losses on account of land acquisition. Stability in fiscal concession is absolutely essential to ensure credibility of Government intensions. Tables and diagrams given below containing the information regarding 'Level of investment in functional SEZs in India', 'Level of Employment in Functional SEZs' in India', 'Exports from SEZs during the last Five Years (from2003-04 to 2007-08)', gives clear picture of efficacy of SEZs in Indian economy.

Diagram No.1

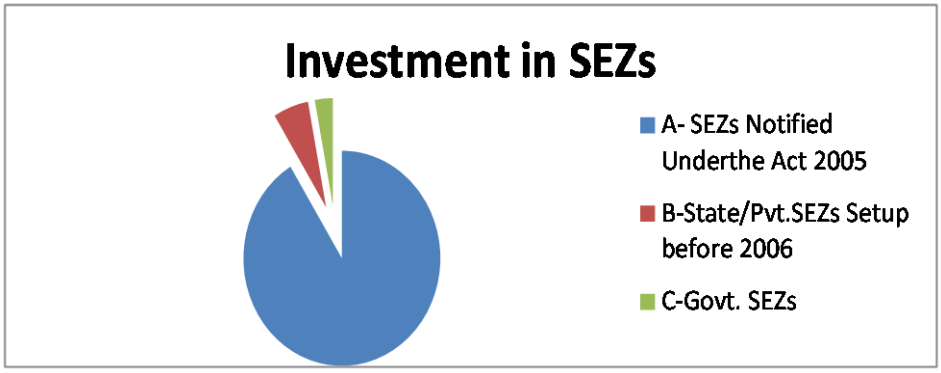


Table No.1
Level of Investment In Functional Sez's In India

INVESTMENT (As on 30th June, 2009)	Incremental investment	Total Investment
SEZs Notified under the Act	Rs.1,04,589.3cr	Rs.1,04,589.3 cr
State/Pvt. SEZs set up before 2006	Rs.4,901.27 cr	Rs.6,657.58 cr
Government SEZs	Rs.1,114.45 cr	Rs. 3,393.65 cr
Total	**Rs.1,10,605.02 cr**	**Rs.1,14,640.53 cr**

Source: Special Economic Zones in India, Ministry of Commerce and Industry, Deptt. Of Commerce. www.sezindia.nic.in

Diagram No.2

Table No.2
Level of Employment in Functional SEZ's In India

EMPLOYMENT (As on 31st March, 2009)	Incremental Employment	Total Employment
SEZs Notified under the Act	1,34,627persons	1,34,627persons
State/Pvt. SEZs set up before 2006	43,422 persons	55,890 persons
Government SEZs	74,686 persons	1,96,922 persons
Total	**2,52,735 persons**	**3,87,439 persons**

Source : www.sezindia.nic.in

Table No.3
Exports from SEZs during the last Five Years (2003-04 to 2007-08)

Year	Value (Rs. Crore)	Growth Rate (over previous year)
2003-2004	13,854	39%
2004-2005	18,314	32%
2005-2006	22 840	25%
2006-20007	34,615	52%
2007-2008	66,638	92%
2008-2009	99,689	50%
2009-2010 as on 30th June2009	42501.76	

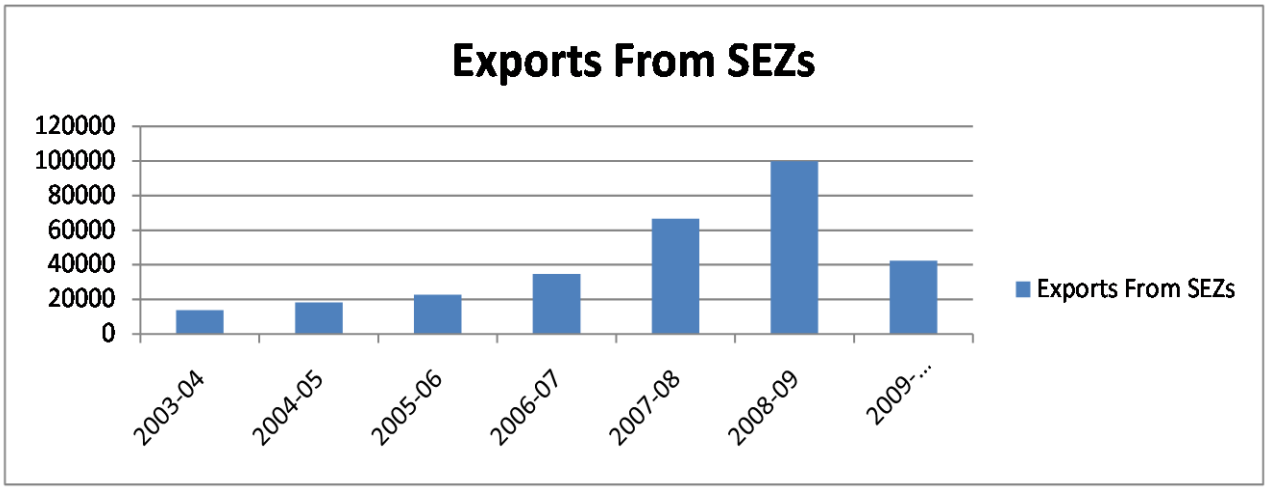
Source : www.sezindia.nic.in

The new Special Economic Zones, including the Reliance Industries' Jamnagar refinery, would help increase India's SEZ exports by 40 per cent this fiscal (2009-10), righting partially the dismal picture of the country's total exports, according to government estimates. About 10 new SEZs would be operational within this fiscal. Exports from the RIL's Jamnagar refinery are expected to be Rs 35,000 crore (Rs 350 billion), a Commerce Ministry official said. Exports from 91 SEZs in 2008-09 were Rs 99,689 crore (Rs 996.89 billion). "New SEZs are coming up...by the end of this fiscal, more and more units would start operating," Director General of the Export Promotion Council for EOUs (Export-oriented Units) and SEZs L B Singhal said.

FDI in SEZ in India

Since the beginning of economic liberalization in 1991, the attractiveness of India as an investment destination has grown at a steady pace. According to a study by Goldman Sachs, Indian economy is expected to continue growing at the rate of 5% or more & is slated to become the fourth largest economy by 2050. This favorable scenario has been made possible through an increased level of flexibility & rationalization of the policies by the government as regards foreign direct investment. India continues to be an attractive foreign direct investment destination to foreign investors despite ongoing controversies over special economic zones, a global investments expert said in New Delhi.

Diagram No.3



Source: www.sezindia.nic.in

JVDheldden, the Indian arm of 'FDI', released a study called 'India as FDI Destination', which said despite huge FDI interests, the country is not realising its full potential because of the business environment and policy- related impediments. Noting that the SEZ issue was a 'political landmine' in India, Courtney Fingar, editor of *Financial Times*' global investments magazine

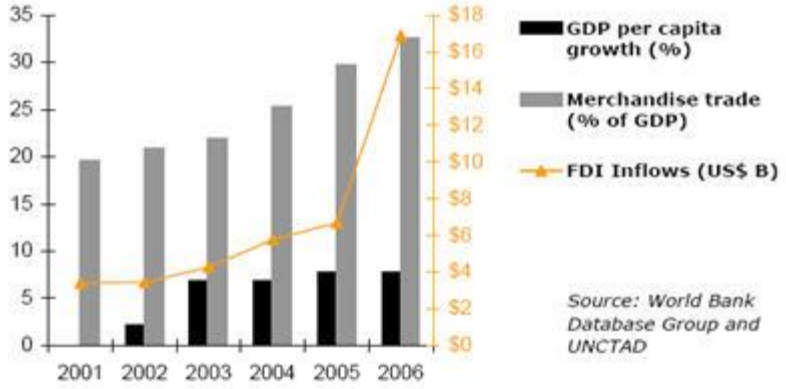
FDI, said SEZ investment is a 'double- edge sword' that could be a mode of development at some places but not everywhere. "It may be too early to say what it will do for India, but apart from anything else, the creation of such zones do send a signal to the global business community about the country's keenness for FDI," Fingar said. Some of the policy measures taken to attract foreign direct investment (FDI) in Special Economic Zones (SEZs) include:

- FDI upto 100% under automatic route for all manufacturing activities except arms and ammunition, explosives and allied items of defence equipments, defence aircraft and warships, atomic substances, narcotics and psychotropic substances and hazardous chemicals, distillation and brewing of alcoholic drinks and cigarettes/cigars and manufactured tobacco substitutes.

- 100% FDI allowed for development of townships including housing, commercial and recreational facilities on a case-to-case basis.

- Facility to foreign companies to set up manufacturing units in SEZs as branch operation on standalone basis without approval from RBI.

Diagram No.4
FDI Inflows in India



The FDI in flow in India has dipped to $6,256 million in the first quarter of 2009 from $14,197 million during the same period last year. According to UNCTAD's World Investment Prospects Survey 2009-11, India has slipped by one notch to third position as the most preferred foreign direct investment (FDI) country. India is among the world's 15 largest FDI recipients in 2008. Foreign direct investment (FDI) in India may erode sharply from the record $42 billion in 2008

with trans-national corporations (TNCs) going slow on expansion plans following the global financial meltdown, an UNCTAD report said.

Table No. 4
Exports as Percentage of GDP

Country	1990	2001	2004
China	13.3	22.6	35.9
Indonesia	23.4	34.9	27.8
Malaysia	65.0	100.0	107.0
Thailand	26.8	54.6	58.7
Philippines	18.5	44.0	45.0
India	5.7	9.3	11.3

[Source: Development Indicators 2006, Asian Development Bank; www.Adb.Org]

According to Crisil research estimates, eight infrastructure sectors, including oil and gas, power, roads, ports, airports, railways, urban infrastructure and telecom, are expected to draw more than $345.28 billion investment in India over the 2007-08 and 2011-12 period. Rising financial overheads due to high interest rates as well as a global slowdown are not likely to impact investments much as infrastructure projects have long gestation periods, the Crisil report revealed. Further, the telecom sector has the least risk potential of the lot. The report forecasts that during the specified period, power will grow at 60 percent, roads at 100 percent, airports at 400 percent, ports by 160 percent and railways at 250 percent. Crisil Research head Sachin Mathur said: "There are three key reasons for being confident about investment in Indian infrastructure - improved institutional framework for enabling infrastructure investments, especially by the private sector; experience gained by governments, regulators and players regarding the process of participation through concessions in infrastructure projects". The third key reason, Mathur added, was the improved project execution and financial capabilities of players which allow them to handle multiple, larger and more complex projects.

Impediments and Suggested Measures

Developers of existing special economic zones continue to face problems in accessing credit from banks because of the Reserve Bank of India's categorisation of SEZ projects as a real estate activity, which invites stringent capital adequacy norms. As a result, the zones have to incur higher borrowing costs on loans. Moreover, banks have lesser money available for lending to real estate activity. The promise of $500 million-plus investment opportunities in diverse sectors in India was marred by the obstacles at various levels. There is no single window clearance, the government must realise the need to establish a one-stop shop at the Centre to implement policies and procedures to enhance investment as well as facilitate high-value projects across ministries and departments. Multiplicity of agencies is also undermining the investment efforts in the country. "Many agencies are engaged in doing similar activities relating to FDI -- such as

FIPB, DIPP, FIIA, IC, SIA, and so on," the study said. Bureaucratic delays, discretionary interpretation, vested interests, bias and subjective practices are retarding the pace of FDI in India, it said. There are also 'too many touch points' with officials and agencies at central and state government levels, it said.

Dwelling on policy-related impediments, it is found that there were investment restrictions and entry route barriers in several sectors of significant investment potential and interests. Specific sectors include private banking where RBI approval is required for FDI beyond 5 per cent. Regulatory constraints are hitting the private equity and venture capital as much as the 26 per cent FDI cap in insurance. Though the retail front witnessed growth after allowing 51 per cent FDI in the single brand, the multi-brand retail continues to be closed area for the foreign investor, the study said. Despite these impediments, India remains an attractive destination for its high returns in foreign investment at 20 per cent, compared to China (13 per cent) and Thailand (12 per cent).

Keeping the government's goal of attracting $150 billion of FDI in mind, the Investment Commission chaired by Ratan Tata has asked the government to provide labour flexibility, remove or reduce restrictions on sectoral caps as well as promote SEZs for key sectors in order to boost investments in the country. In a report submitted to Prime Minister Manmohan Singh, the commission says that the government needs to remove or reduce restrictions on sector caps on all sectors other than those considered strategic. The report asks for the automatic route for all investments within the sector cap.

It has also asked the government to provide a level-playing-field in sectors which are dominated by PSUs and establish an independent central regulatory commission that should be headed by a chief commissioner who is appointed by the President or the Prime Minister. On labour, the report asks the government to ''provide labour flexibility by removing the requirement of state government approval from chapter V-B and permitting Contract Labour in all areas''. For SEZs, the commission says that the government should first promote SEZs for key sectors and then redefine norms on the basis of scale, investment quantum/levels and sector focus.

Apart from these, it has also asked the government to provide long-term visibility and consistency of policy and reduce the number of procedures to ensure greater inflows into the country. The commission has also asked the government to eliminate any scope for discretionary interpretation and establish a VAT like empowered committee framework to sort out centre-state policy issues that need urgent reform. In the report, they have also pointed out inflexible labour laws and bureaucratic delays, discretionary interpretation, vested interest, bias and subjective practices as factors holding back investments flows.

In fact, the Commission has singled out the approval process adopted for getting clearances from the ministry of environment & forests as problem area. In some of the other recommendations made for the government, the commission has identified the need to create a special high-level fast track mechanism for priority sector projects. It has also said asked the government to enhance the availability of skilled manpower for sectors like biotechnology, automotive

engineering, textile, engineering, IT. Here, the commission recommends the government to establish new private educational institutes with international collaborators. Above all it is also very important to change the mind set and ensure a common Indian about the misconceptions with regard to development of SEZs i.e. flexibility of labour laws will be within the constitutional limits, and development of SEZs is not to uproot farmers from fertile or non-fertile land rather to avail the advantages of export from that area —on lines of what is done in China and the US.

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