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Special Economic Zones in India

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Special Economic Zones (SEZs) have been recognised as an important mechanism for trade and investment promotion, creation of infrastructure, employment generation, promotion of regional development, increase in foreign exchange earnings, improving export competitiveness and transfer of skills and technology. These are considered as growth drivers in the developing countries. The SEZs have been in existence for decades, but have attracted renewed attention world-wide in recent years due to globalisation of trade and financial markets.

These zones are marked by minimum bureaucracy, best infrastructure, generous tax holidays, unlimited duty free imports of raw material, other inputs as well as capital goods. Evidently, a SEZ is almost a self contained area with high class infrastructure for commercial operations as well as residential inhabitation. In other words, SEZs have evolved and transformed from the original concept of industrial estates, which were focused on manufacturing for export purposes[1].

International Experiences in SEZs

The expansion and development of the SEZs has been significant during recent years. Thirty years ago, 80 EPZs in 30 countries generated barely $6 billion in exports and employed about 1 million people (Table 1). In 2006, 3,500 SEZs operated in 130 countries and accounted for over $600 billion in exports and 66 million direct jobs. By offering privileged trading terms for manufacturing-based exports, SEZs attract investment and foreign exchange, spur employment generation, facilitate adoption of improved technologies and assist in creation of infrastructure.

Country-wise, the US has more number of Free Trade Zones due to its attractiveness to the foreign commerce and local businesses. China stands next to the US as China has implemented an ambitious export-oriented growth strategy during the 1980s and 1990s, the central feature of which was the establishment of SEZs and Open Coastal Cities (Table 2). Vietnam, Hungary, Costa Rica and Mexico have considerable number of SEZs due to export oriented growth strategy that was adopted by these countries in recent years. Countries in

[1] Reserve Bank of India: Evolution of SEZs and Some Issues; The Indian Experience, A Report dated 22.09.2009, p. 1

the Asian region have also implemented SEZ development strategy in a big way with the objectives of promoting employment and exports.

Table 1: Global Distribution of EPZs/SEZs

Item	1975	1986	1997	2002	2006
No. of Countries	25	47	93	116	130
No. of EPZs	79	176	845	3000	3500
Employment (million)	..	..	22.5	43	66

Source: ILO database on Export Processing Zones.

Table 2: Major SEZs in the World with Employment and Exports in 2007

Country	No. of Zones	Country	Employment (Thousands)	Country	Exports (US $ Million)
1	2	3	4	5	6
China	187	China	50,000	China	$145,000
Vietnam	185	Indonesia	6,000	Malaysia	117,013
Hungary	160	Mexico	1,300	Hong Kong (China)	101,500
Costa Rica	139	Vietnam	950	Iran, Islamic Republic of	87,289
Mexico	109	Pakistan	888	Ireland	82,500
Czech Republic	92	UAE	552	Czech Republic	68,626
Philippines	83	Philippines	545	Algeria	39,423
Dominican Republic	58	South Africa	535	Argentina	36,478
Kenya	55	Thailand	452	Philippines	32,030
Egypt,	53	Ukraine	387	Korea,	30,610
Poland	48	Malaysia	369	Tunisia	20,544
Nicaragua	34	Lithuania	369	Bangladesh	11,716
Thailand	31	Honduras	354	Lithuania	11,404
Jordan	27	Hong Kong (China)	336	Mexico	10,678
UAE	26	Tunisia	260		

Notes: Excludes zones in OECD countries.
Sources: Bearing Point; ILO database; WEPZA (2007); FIAS research[2].

India's Experience in SEZs

I. Historical background

India was one of the first in Asia to recognise the effectiveness of the Export Processing Zone (EPZ) model for export promotion, with Asia's first EPZ set up in Kandla in 1965. To overcome the shortcomings on account of multiplicity of controls and clearances; absence of world-class infrastructure and an unstable fiscal regime and with a view to attract

[2] *Ibid*, pp. 2-3

larger foreign investments in India, 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 minimum possible regulations. SEZs in India functioned from November 1, 2000 to February 9, 2006 under the provisions of the Foreign Trade Policy and fiscal incentives were made effective through the provisions of relevant statutes.

II. Special Economic Zones Act, 2005 and Special Economic Zones Rules, 2006

The Special Economic Zones Act, 2005, was passed by Parliament in 2005. The SEZ Act, 2005, supported by SEZ Rules, came into effect on February 10, 2006, providing simplification of procedures and single window clearance on matters relating to Central and 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; and
- Development of infrastructure facilities[3].

III. Incentives and facilities offered to the SEZs

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. (withdrawn w.e.f. 1.4.2012).
- External commercial borrowing by SEZ units upto US $ 500 million in a year without any maturity restriction through recognized banking channels.

[3] India, Ministry of Commerce and Industry, Department of Commerce, Annual Report 2014-15, p. 133

- 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[4].

IV. Current Status

Seven EPZs set up by the Central Government at Kandla (Gujarat), Santa Cruz (Maharashtra), Cochin (Kerala), Noida (UP),Chennai (Tamil Nadu), Falta (West Bengal) and Visakhapatnam (Andhra Pradesh), were converted to SEZs on announcement of the SEZ Policy. Another EPZ set up in the private sector in Surat was also converted to an SEZ. In addition, 11 more SEZs were set up by the state governments/private sector during the period 2000-2005 in West Bengal (2), Gujarat (2), Madhya Pradesh (1), Uttar Pradesh (1), Rajasthan (1) and Tamil Nadu (4). After the coming into force of the SEZ Act, 2005,437 formal approvals have been granted for setting up of SEZs, out of which 348 SEZs have been notified and are in various stages of operation. A total of 202 SEZs are exporting.

While there is some concentration in certain states, the fact that approved SEZs are spread over 19 states and 3 union territories indicates that these are not confined to any particular region. State-wise and sector-wise distribution of SEZs shown in ***Annexure-I*** and ***II*** as on 31.03.2015. The total land area involved in the formally approved SEZs including notified SEZs is around 55255.33 Ha[5].

The seven major sectors of IT/ ITeS, hardware etc., biotechnology, multi product, pharmaceuticals/ chemicals, engineering, FTWZ and gems & jewellery account for the bulk (84.44 per cent) of the formal SEZ approvals granted so far. IT/ITeS/ electronic hardware/semiconductors is the single most important segment accounting for about 63 per cent of the total formal approvals followed by biotech and multi product SEZs. Approximately 80 per cent of the 437 formal approvals issued so far have reached the stage of notified SEZs.

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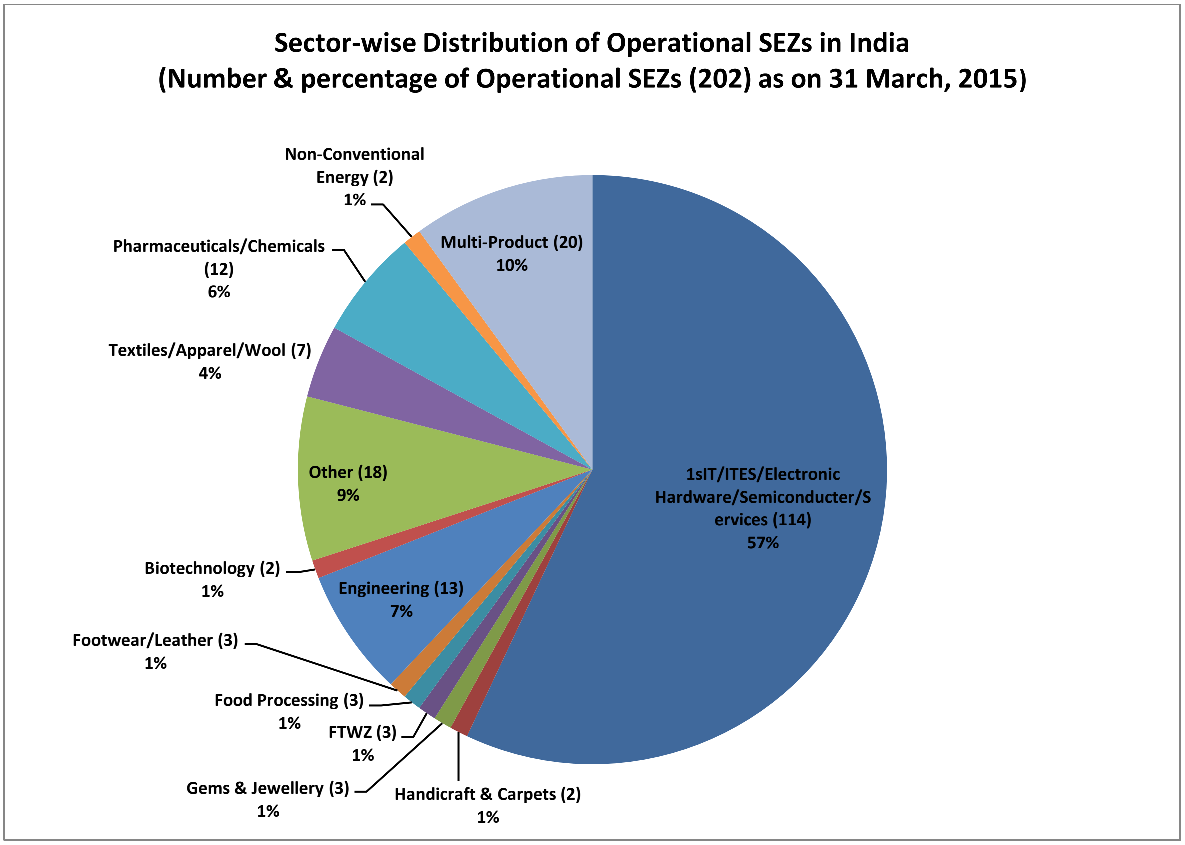
[4] http://sezindia.nic.in/about-fi.asp

[5] *Op.cit*., Annual Report 2014-15, pp. 133-134 (Statistics as updated by Ministry of Commerce and Industry)



Employment, Investment and Exports in SEZs

The details of employment and investment generated in the SEZs are given in boxes below:

Direct Employment in Special Economic Zones (As on 31 March, 2015)	Investment in Special Economic Zones (As on 31 March, 2015)
SEZs in India provide direct employment to over 14,42,316 persons; The incremental employment generated by the SEZs in a short span of time since the SEZ Act came into force in February 2006, is of the order of 13,07,612 persons.	The total investment in the SEZs is Rs. 3,38,794.46 crore. The incremental investment in the Special Economic Zones notified under the SEZ Act, 2005 is Rs. 3,34,758.95 crore since the coming into force of the SEZ Act in February, 2006

Export Performance

Exports from SEZs in the financial year 2014-15, reached around As 4,63,770 crore. Exports from the functioning SEZs during the last seven years and current year are in Table below.

Exports from functioning SEZs

Year	(Rs. Crore)	Increase over previous year (%)
2008-09	99,689	50.00
2009-10	2,20,711	121.40
2010-11	3,15,868	43.11
2011-12	3,64,478	15.39
2012-13	4,76,159	31.00
2013-14	4,94,077	4.00
2014-15	4,63,770	-6.13

V. Recent Initiatives

- The SEZ Rules were amended on August 12, 2013 to allow:
  - Reduction in the Minimum Land Area Requirements for setting up of SEZs.
  - Introduction of Graded Scale for Minimum Land Criteria.
  - Introduction of sectoral broad-banding provisions.
  - Dispensation of minimum land requirements for IT and ITeS SEZs. - Transfer of Assets by SEZ units upon their exit.
- Mapping of activities related to developers and units in SEZs were identified and timelines for completion of the said activities were prescribed and implemented. This was launched on 14.8.2014 in all zones.
- Digitisation and online processing of various applications have been introduced in all zones w.e.f. No-vember 1, 2014.
- Dual use of infrastructure in NPA (non processing areas) has been allowed by the notification date -January 2, 2015.
- Efforts are being made to extend the ICEGATE to SEZs. A pilot project has been launched in Madras SEZ on January 19, 2015.
- Standardisation of procedures, practices and forms in all SEZs has been ensured. Procedures for regulating certain activities which are not indicated in SEZ Act and Rules have been standardised, e.g.

- Utilisation of goods by developer/co-developer
- Approval of material for authorised operations by developer/co- developer
- Information required for renewal of LOA for 5 years
- Format for lease deed and its renewal, and
- Format for annual performance report of the units has been revised and simplified[6]

Appraisal of SEZ

The SEZ Act—launched in 2006 with great expectations—was the first giant step towards promoting large-scale industrialisation. The accompanying table shows that despite changing global conditions and unstable policies, it has made phenomenal progress in terms of employment and investment, based on the incentives offered by the government. But after the MAT and DDT incentives were withdrawn in 2011, it has become difficult for SEZs to attract new units. The table shows that the number of SEZs has declined sharply, and more than 15,000 hectares of the SEZ land has already been denotified since 2012. The available data shows that over 41.31% of the processing area in notified SEZs is lying vacant[7].

Fact Sheets of SEZs

	Approval (No.)	Notified (No.)	In principle approval (No.)	Operational (No.)	Land (hectare)	Unit (No.)	Investment (cr.)	Employment (No.)
As on 31.3.2012	589	389	48	153	71,502	3,400	2,01,875	8,44,916
As on 30.9.2014	491	352	32	196	56,067	3,864	2,92,779.59	13,50,071

As on 30 September, 2014

In the light of the above factors it is observed that SEZ losing their sheen. Reflecting erosion of investor interest in special economic zones, 57 developers, including JSW Aluminum Ltd and Parsvnath, have decided to surrender their SEZ approval applications. Earlier, over 50 SEZ developers surrendered their projects, SEZs, which emerged as major export hubs started losing sheen after imposition of minimum alternate tax (MAT) and

[6] *Ibid*, pp. 134-136 (statistics as updated by Ministry of Commerce and Industry)
[7] Financial Express, New Delhi, dated 27.02.2015 (statistics as updated by Ministry of Commerce and Industry)

dividend distribution tax (DDT) at 10% in 2011-12 which has severely hampered the progress of SEZs Scheme[8].

Parliamentary Standing Committee's Report

In a recent development, a Parliamentary Standing Committee headed by Dr. Chandan Mitra called for the restoration of tax benefits for special economic zones (SEZs) to help revive the programme. It recommended that the Department of Commerce should take up the matter afresh with the Ministry of Finance and sensitise the ministry about the importance of these zones in the well being of Indian economy.

"The committee agrees that the original benefits in terms of minimum alternate tax (MAT) and dividend distribution tax (DDT) needs to be restored". It also opined that SEZs have lost direction after the initial euphoria and it is worrisome to learn that out of 352 notified SEZs, only 168 are operational in December 2014 because there are reports that a large number of these SEZs being "rapacious" and turning as "real estate players" rather than creating a manufacturing and service eco-system.

The committee was of the opinion that a performance audit of the SEZs may be carried out by C&AG every year" and recommends the Department of Commerce to furnish details on de-notified zones within one month so that it may decide future course of action in the matter[9].

Some Suggestive Policy Option

In the above backdrop of review of present status of SEZ depicted in the CAG Report and Parliamentary Standing Committee's viewpoint some suggestive policy options are outlined below. Some of the following viewpoints, may be necessary preconditions to achieve the desired objectives and to balance the outcome of creation of more SEZs in the country:

- The location of SEZs must be such as to promote manufacturing exports. Linkage to ports and airports should be taken into consideration while setting up the SEZs. Well developed transport infrastructure may improve the performance of the SEZs even if they are located little far off from these points and then it may not necessary to locate the SEZs very near to the ports/airports.

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[8] Hindu Business Line, New Delhi, dated 11.2.2015
[9] India, Rajya Sabha, DRSC on Commerce, Demands for Grants 2015-16, 117th Report

- Encouragement for modern version of SEZs like free ports, free coastal zones, setting up of growth poles and clusters should be encouraged. The experience of countries like Korea, Japan, Malaysia, Hong Kong, Taiwan and Singapore confirms this.

- Free ports may be far bigger than the SEZs and should offer a world class environment in terms of legal framework, regulatory procedures, infrastructure, production facilities and easy access.

- Offering of greater flexibility to firms in terms of plant location in the zone would encourage the investors' participation.

- The size of each SEZ should be such as to promote the efficient provision of infrastructure services, particularly the provision of power, water and other services.

- Due recognition can be given to the ongoing tariff reform where the non-agricultural peak tariff is already 10 per cent. As the peak tariff rate approached 5 per cent, there will be little need for duty free zones. The administrative procedures required for monitoring and administrating duty free imports will no longer be cost-effective.

- Efficient investor friendly administration is crucial to the success of SEZs. This may be difficult to achieve if there is a proliferation of zones. Therefore, limiting the number of zones, particularly for specific product zones, would be easy to administrate.

- While providing approval, prioritisation of the zones is needed according to the strategic importance of the product and development needs of the region.

- On investment front, encouragement for more greenfield FDI in the zone to supplement domestic investment would attract more private investors. China is the glaring example where about 20 per cent of the FDI has flown into SEZs. Allowing the private sector to be responsible for investment in the zones would sustain the development. Domestic investment in the zone should have long-term orientation and not fly by night characteristic.

- While selecting the location, it would be necessary to exclude the agricultural lands altogether from the promotion of SEZs.

- Establishment of well balanced compensation and rehabilitation policy to be designed for displaced people.

- Maintaining a stable and fair tax regime with no special privileges would enhance the fiscal strength of the country. At the same time, it would be necessary to physically enclose the zones to curb revenue pilferage. If required, tax privileges should be given at the very initial stage.

- Enforcement of good governance in the SEZs with flexible labour laws would be an important component for SEZ success.

- A natural fall-out of successful operations of SEZs is creation of effective forward and backward linkages. It should be noted that just establishing SEZ does not guarantee investment interest, higher industrial activities and exports as experienced in African countries[10].

Conclusion

SEZs are an important mainstay for supporting the ‘Make in India’ campaign and boosting exports. The onus of stimulating investment in SEZs lies with the government. The future of SEZs would greatly depend on the future course of action of the government to bring stability to this policy regime and reinstate the fiscal incentives carved out under this scheme[11].

[10] *Op.cit.,* Reserve Bank of India: Evolution of SEZs and Some Issues
[11] Financial Express, New Delhi, dated 26.2.2015

Annexure-I

State-wise distribution of approved SEZs (As on 31.03.2015)

States/UTs	Formal Approvals	In-principle approvals	Notified SEZs	Exporting SEZs (Central Govt. + State Govt./Pvt. SEZs + notified SEZs under the SEZ Act, 2005)
Andhra Pradesh	33	4	29	19
Chandigarh	2	0	2	2
Chhattisgarh	2	1	1	1
Delhi	2	0	0	0
Goa	7	0	3	0
Gujarat	32	4	27	18
Haryana	29	3	25	6
Jharkhand	1	0	1	0
Karnataka	59	0	39	26
Kerala	32	0	25	15
Madhya Pradesh	13	1	8	2
Maharashtra	61	9	52	25
Manipur	1	0	1	0
Nagaland	2	0	2	0
Odisha	8	1	4	2
Puducherry	1	1	0	0
Punjab	4	0	2	2
Rajasthan	9	1	8	4
Tamil Nadu	54	4	50	36
Telangana	48	0	42	26
Uttar Pradesh	26	1	22	11
West Bengal	12	2	5	7
GRAND TOTAL	**437**	**32**	**348**	**202**

Source: http://sezindia.nic.in (as updated by the Ministry of Commerce and Industry)

Annexure-II

Sector-wise Distribution of approved SEZs (As on 31.03.2015)

Sectors	Formal Approvals	In-principle approvals	Notified SEZs	Exporting SEZs (Central Govt.+ State Govt./Pvt. SEZs + notified SEZs under the SEZ Act, 2005)
Agro	5	2	5	1
Airport based multiproduct	3	0	0	0
Auto and related	1	1	1	1
Aviation/Aerospace/ Animation & Gaming/ Copper	6	1	5	5
Beach & mineral/ metals	3	0	3	0
Biotechnology	23	0	16	2
Building prod./mal./ transport equipments / ceramic and glass	2	2	2	2
Electronic product/Industries	2	0	2	2
Engineering	15	1	15	13
Footwear/Leather	5	0	4	3
Food Processing	4	0	3	3
FTWZ	10	4	7	3
Gems and Jewellery	8	3	5	3
Handicrafts & Carpets	3	0	2	2
IT/ITES/Electronic Hardware/Semiconductor/Services	275	0	220	114
Metal/Stain. Steel/Alum/Foundry	3	0	3	0
Light Engineering/Metallurgical Engineering /Automotive Components	1	0	0	0
Multi-Product	21	11	16	20
Multi-Services	6	1	6	2
Non-Conventional Energy	2	0	2	2
Petrochemicals & petro./oil and gas	2	1	0	0
Pharmaceuticals/chemicals	17	2	17	12
Port-based multi-product	6	1	3	2
Power/alternate energy/ solar	4	1	3	3
Textiles/Apparel/Wool	6	1	6	7
Writing and printing paper mills	2	0	1	0
Granite processing Industries and other allied machinery/ manufacturing	2	0	1	0
GRAND TOTAL	**437**	**32**	**348**	**202**

Source: http://sezindia.nic.in (as updated by the Ministry of Commerce and Industry)