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SEZs AND EXPORTS: AN INDIAN OVERVIEW

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ABSTRACT

Special Economic Zones are the magnet and glue which have been set up with the main objective of increasing the export potential of the country. SEZ are geographical regions that have liberal economic laws like tax and business incentives to attract the foreign investment and technology as well as to reduce the cost of production to make our 'products' more competitive in the international market. The purpose of this paper is to show the changes in export and the contribution of SEZs in its enhancement. It compares the expected growth of exports from SEZs and expected growth of total exports with actual growth of exports from SEZs and actual growth of total exports over the span of fifteen years starting from 2000 to 2015, to find out difference in the actual and expected values, if any, to show the degree of mutual dependence and to bring out the reasons behind such difference. The paper also focuses on finding possible solutions of the shortcomings of SEZs in India with a purpose to enhance exports from SEZs and overall growth.

Keywords: *Special Economic Zone, investment, employment, export generation, regional development.*

1. Introduction

The New Economic Policy (NEP) was declared in 1991 marking the beginning of the new era of Liberalisation, Globalisation, and Privatisation. The Indian economy was open to the world to meet the challenges and grab the opportunities of the new world order. The competition raised the need to uplift the economy in every field. With the passage of time, Indian economy has not only found a new direction but have developed new dimensions which have set the process of integration with the world economy, which itself is turning into a global village. The formation of World Trade Organisation (WTO) in this context is an important step which aims at the economic development by increasing international trade.

In fact economic development and international trade, especially, the exports are highly correlated. Evidence shows that many countries of the world have developed their economies on the basis of their export potentials.

Broadly speaking, economic development which is a multidimensional phenomenon implies the process of securing levels of productivity in all the sectors of the economy. It is a result of both, economic and non- economic factors. Among the different economic factors, which contribute to the economic development of a country, one which is of great importance is its export potentials.

Over the years various public policy measures which actually or potentially enhance exporting activity at the company, industry, or national level have been developed. These policy measures are known as export promotion techniques. The main goal of these steps is to prepare the "potential" industries for competition with the foreign rivals. One of those measures adopted is the establishment of Special Economic Zones (SEZs). These are special geographical areas within a nation those offer incentives like tax concessions, subsidies etc to the business houses thereby enhancing the production process.

The first Special Economic Zone (SEZ) was established in 1937 in New York, the United States of America (USA), named as "Foreign Trade Zone" (FTZ). India established SEZ with the name of "Export Processing Zone". India was the first country in Asia to realize the importance of the export zone. Asia's first EPZ was set up in Kandla in 1965. But these EPZs were faced by the shortcomings on account of multiplicity of control and clearances; absence of world class infrastructure and an unstable fiscal regime. With a view to attract larger foreign investments in India, the Special Economic Zones Policy was announced in April 2000.

2. SEZ – meaning

A Special Economic Zone is a specified, delineated and duty free geographical region within a nation or state which has a distinct legal framework providing for more liberal economic policies and governance arrangements. A 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. 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.[i] These SEZs all over the world are supposed to increase trade and investment, spur employment, and improve administration by way of taxation, trading quotas, customs, and labour regulations and are generally called as "Export Houses".

SEZs in India were established in an attempt to accelerate foreign investment and exports emphasizing the need for a global platform for the domestic firms by reducing the cost of production and increase their efficiency and competitiveness so, the price of the 'product' becomes more competitive in the international market, thereby, increasing the exports and thus accelerating the process of economic growth. This gave them an opportunity to grow and expand. India's special economic zones (SEZs) are certain localities which offer tax and other incentives to their resident businesses. Structured closely on the already successful model of China, they are designed to help stimulate both foreign and domestic investment, boost India's exports, and create new employment opportunities.

Later on an act governing the SEZs came into force to lay down the rules applicable to them for their proper functioning. The Special Economic Zone Act 2005 came into force with effect from 10th February 2006. It is an act to provide for the establishment, development and management of the Special Economic Zones for the promotion of exports and for matters connected therewith or incidental thereto. India's SEZ Act 2005 further amended the country's foreign investment policy and converted its EPZs to SEZs. Since the act's promulgation, the Indian government has also been accepting proposals for additional, far smaller SEZs, which must be proposed by developers to the Indian Board of Approval. As of year 2014-15, there exist 329 notified SEZs out of which 204 SEZs are in operation and a massive 412[ii] have already been formally approved for operation. The Special Economic Zones can be set up in public- private partnership, in joint sector or by the state government.

3. Features

Some of the salient features of Indian Special Economic Zones are listed below:

- Exemption from customs duty, excise duty, etc. on import/domestic procurement of goods for the development, operation and maintenance of SEZs, and the units therein.
- 100 percent income tax exemption for 5 years, 50 percent for the next five years for offshore banking units located in SEZs and 50 percent of ploughed back export profits for five years thereafter for SEZ units.
- Exemption from capital gains on transfer of an undertaking from an urban area to SEZ.

- 100 percent income tax exemption to SEZ developers for a block of 10 years in 15 years.
- Exemption from dividend distribution tax to SEZ developers
- A provision for setting up of International Financial Services Centre in SEZ has been proposed with the same incentives and facilities as available to offshore banking units.
- Exemption to SEZ developer and units from Minimum Alternate Tax
- CST Exemption to SEZ developer and units on inter-state purchase of goods
- Establishment of designated courts and a single enforcement agency to ensure speedy trial and investigation of offences committed in SEZs.
- Encouragement to State Governments to liberalize State laws and delegate their powers to the development commissioners of the SEZ to facilitate single window clearance.
- Indian SEZs are developed by government, private and joint sector, unlike its international counterparts where zones are chiefly maintained by their respective governments. This provides equal prospects to both Indian and global players.
- 100% of Foreign Direct Investment is allowed for all endowments in Special Economic Zones, apart from activities cataloged under the unconstructive record.

4. Objectives

The main objectives of SEZ in India are as follows:

- Generation of additional economic activity
- Promotion of exports of goods and services
- Promotion of investment from domestic and foreign sources
- Creation of employment
- Development of infrastructure facilities
- Simplified procedures for development, operation, and maintenance of the Special Economic Zones and for setting up units and conducting business
- Single window clearance for setting up of a SEZ and an unit in SEZ
- Single window clearance on matters relating to Central as well as State Governments
- Easy and simplified compliance procedures and documentations with stress on self-certification.

5. SEZs: performance analysis

- *Graphical Analysis*

Analysis of the growth of exports has been conducted over a span of twenty years. The main purpose was to improve the trade balance. It has been observed over the years that there has been a considerable increase in the value of exports. In the year 1966 there has been an average of 4 million rupees which increased to 40,018 million rupees by 2000.[iii]

The following table speaks about the growth of exports from the year 2000 to 2015. The data here brings out the significant export promotion due to SEZ policy of India.

Years	Exports				Growth over previous year[iv]
	Total (Rs. Crores)		from SEZs (Rs. Crores)		
	ACTUAL	EXPECTED	ACTUAL	EXPECTED	
2000-2001	2,03,571	-	8,552	-	-
2001-2002	2,09,018	214465	9,190	9828	7.4%
2002-2003	2,54,913	273842	10,053	10766	10%
2003-2004	2,93,367	319038	13,854	14604	38%
2004-2005	3,75,340	395607	18,309	19245	32%
2005-2006	4,56,418	478936	22,840	24059	25%
2006-2007	5,71,779	583465	34,615	33022	52%
2007-2008	6,55,864	681087	66,638	53892	93%
2008-2009	8,40,755	819507	99,689	81110	50%
2009-2010	8,45,534	908019	2,20,711	146891	121%
2010-2011	11,36,964	1070792	3,15,868	225871	43.11%
2011-2012	14,65,959	1292441	3,64,478	297289	15.39%
2012-2013	16,34,318	1502760	4,76,159	382872	31%
2013-2014	19,05,011	1734085	4,94,077	451088	4%
2014-2015	14,11,338[v]	1775908	4,63,770	494090	-6%

Table 1 Source: Ministry of Commerce, Government of India and Economic Survey

The data reveals that the share of exports contributed by SEZs has considerably increased over the years. The rate of growth has reached a maximum of 121% in 2009-10, after which a decrease in the rate of growth is observed. Though the rate of growth declines but the exports, be it from SEZs or total, have continuously increased even after 2009 till 2013. The year 2014 observed a decline in total exports. The line graph below also shows a continuous increase in total exports till 2013-14 but there is a decline in the year 2014-15.

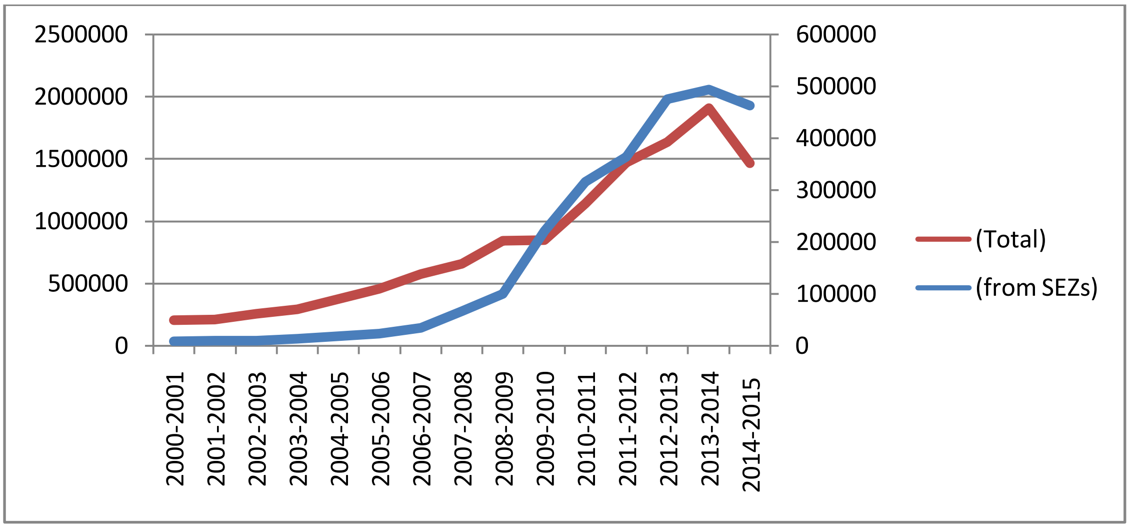

Figure 1 GROWTH OF TOTAL EXPORTS AND EXPORTS FROM SEZS

- *Reasons for decline in 2014-15*
  - ❖ The cost benefit analysis of SEZ policy shows that the imposition of MAT has made SEZs unattractive and adversely impacted the investor sentiment.
  - ❖ The uncertainty of tax regime has an impact on investment. The withdrawal of direct tax benefits has been a setback for the SEZ programme and it is assumed to affect its future prospects.
  - ❖ India has signed a number of free trade agreements (FTAs), with countries such as Sri Lanka, Japan and the Association of Southeast Asian Nations (ASEAN), under which import duties have been slashed to zero for several product lines. This impacts local sales of SEZ units, which are taxed at higher rates.
  - ❖ Taxation issues are not the only ones impeding SEZs. Location, infrastructure, logistics and professional zone management also affect the success of SEZs. Another major reason for the SEZs languishing is the absence of external infrastructure support. The SEZs have to be connected with world-class ports,

airports, roads and rail with Customs authorities adopting international best practices in trade facilitation. This is not the case at present. Deficiencies in the availability and quality of power are an equally important constraint.

- *Trend Analysis of the SEZs data over the past fifteen years*
    - ❖ Methodology: The collected data of the past fifteen years starting from 2000-2001 to 2014-2015, has been analysed in the form of time series analysis to depict the expected value of the next year which is 2015-2016. We have used MS Excel to perform the trend analysis.
    - ❖ The expected values satisfy the linear trend equation: **y = mx + c;** where y is the value of total exports and exports from SEZs for the upcoming year, b is the slope of the trend equation, x is the year and c is constant.
    - ❖ We have also taken help of statistical formulas to assist the data analysis. We have manually calculated the value of the constant using equation $\sum y = nc + m\sum x$; where n is the number of years.

	Sum	Constant	**Expected or trend value for 2015-2016**
Exports from SEZs	26,18,863	1,74,590	**4,94,090.494**
Total exports	1,22,60,419	8,17,343	**17,75,908.98**
Correlation between total exports and exports from SEZs	**0.969** Implies that there is a fairly high degree of positive correlation between total exports and exports from SEZs		

- *Conclusion*
    - ❖ The difference between the expected and actual values of total exports and exports from SEZs can be observed. Expected values of both total exports and exports from SEZs are much greater than the actual values.
    - ❖ Correlation coefficient between the total exports and exports from SEZs shows a higher positive correlation.

6. Problems with SEZs

- *Imbalanced regional and sectorial development*: The SEZs are largely driven by the private sector, which has little concern for a balanced regional and sectorial development. More than two-thirds of the notified SEZs are located in five States — Andhra Pradesh, Tamil Nadu, Maharashtra, Karnataka, and Gujarat — which account for more than 90 per cent of the investment made and 83 per cent of the employment generated. They point out that the bulk of the employment has been in the IT-ITES sector in Tamil Nadu, Karnataka, Andhra Pradesh, and Punjab. In Maharashtra and Gujarat, it has been predominantly multi-products and services. The eastern region has been lagging in this respect. The flow of FDI into India has shown a significant increase since 2003-04, it is still less than what flows into China and that sector-wise, manufacturing industries and services have been major beneficiaries of the FDI. Therefore SEZ policy should be for short period and not for the long run otherwise it will lead to regional imbalances and discontentment which will defeat our aim of balanced and sustainable development.
- *Tax incentives*: Tax incentives granted to SEZs are seen as breaching World Trade Organization rules that bar financial contributions by a government or public body. Moreover there is a lack of clarity in the tax incentives. Maharashtra Chief Minister Prithviraj Chavan highlighted that 23 of the 146 SEZ applicants in the state had abandoned their plans due to lack of clarity on taxation, especially on the dividend distribution tax. This problem should be tackled as early as possible.
- *Environmental issues*: Whenever we talk about industries, environment comes very usually as one of the important concerns. Industry uses natural resources at a huge scale. Proper utilization of natural resources is expected at all levels but simultaneously over utilization, reckless operation etc. adversely affects the ecological balance. Therefore to protect the environment from the whims and fancies of the selfish industrialists it has become necessary to frame and implement rigid laws in order to prevent any kind of harm to environment and also to undertake a subsequent survey to find out the necessary implications left out on the environment by the industry. SEZs also therefore should not be exempted from the environment regulations. In other words environment cannot be sacrificed on the excuse of economic development of the country. There should be no compromise in this regard.
- *Agricultural land and crop production*: The biggest challenges faced by SEZ's in today's scenario are the taking away of agricultural land from the farmers. The

farmers are being paid disproportionate money which is not in lieu of the current land prices. The best example could be seen in the case of farmers from Kalinganagar in Orissa where the money given was disproportionate to as high as 1:10 with respect to the market rates. Moreover SEZ's are leading to decrease in crop production thus slowing down of agricultural activity in the country. More and more farmers are moving towards the lucrative manufacturing side in search of greater economic security. Moreover the greatest problem that seems to be emerging out is that arable land is being used for non-agricultural purpose which could lead to food crisis and loss of self-sustenance in future. In a vast country like ours where a large population is dependent upon agriculture, this becomes all the more important to save the agriculture land for food production and should not be approved for SEZ development.

- *Efficiency and effectiveness*: As evidence over the years has shown, this single-minded pursuit of growth has lowered the efficiency and effectiveness of economic policies, besides incurring huge resource and environmental costs.

8. SEZ and India : A roadmap to future

- Separate export promotion councils should be set up by state governments to drive foreign trade at the local level and not rely solely on the Central government's interventions.
- FDI could also help in providing our farmers to gain access to technological better farming methods.
- A more stable tax regime is promised by the Government at the centre by abandoning India's controversial retrospective tax policies.
- SEZs may include incentives like exemption from minimum alternate tax and dividend distribution tax.
- In relation to the land acquisition problems of farmers, the new policy implies that private developers will have to deal directly with farmers and landowners to acquire SEZ land. There will be a free market in land for once, without interference from the state. The new National Rehabilitation and Resettlement (NPR) 2006 policy suggests that first priority should be to provide land for land. People whose lands are acquired should get jobs in the new industries established on their land. The compensation package includes allotting a free house site to the affected family, allotting cultivable

land and a rehabilitation grant equivalent to 750 days minimum agricultural wages, giving fishing rights where dams are made.

- The principle of Corporate Social Responsibility is also applicable to SEZs. Corporate social responsibility must be taken into consideration to respect environmental concerns; to not to deprive the indigenous people from their long time entitlements; to ensure social security measures to the people working and the like in those de-regulated zones.
- The cost and benefit analysis must be done before taking up any project. Resources used by the industries are exhaustible and non-renewal, so must be used keeping into account the needs of future generations.

9. Conclusion

The SEZ's could drastically improve the economic activity in the country, make the country's export competitive and globally noticeable. It is expected to trigger a large flow of foreign investment, improve infrastructure and productive capacity and leads to creation of employment opportunities. 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, if not fully it 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 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 set up industries in the SEZ's making it profitable and meeting its desired results!

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[ii] Source- www.sez.nic.in

[iii] Source- www.sez.nic.in

[iv] Growth is calculated by the formula: [(year1-year0)/year0]

[v] The total export data of the year 2014-15 is taken from April 2015 to January 2016.