SPECIAL ECONOMIC ZONES (SEZS): TOOL FOR SUSTAINABLE GROWTH

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ABSTRACT

Special Economic Zone (SEZ) is a geographical region that has economic laws that are more liberal than a country's typical economic laws. 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. 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.

As of 2007, more than 500 Special Economic Zones have been proposed, 220 of which have already been created. This has raised the concern of the World Bank, which questions the sustainability of such a large number of Special Economic Zones.

In India, Special Economic Zones are being established in an attempt to deal with infrastructural deficiencies, procedural complexities, bureaucratic hassles and barriers raised by monetary, trade, fiscal, taxation, tariff and labour policies. Since country-wide development of the infrastructure is expensive and implementation of structural reforms would require time, Special Economic Zones/Export Processing Zones are being established as industrial enclaves for expediting the process of industrialization. This paper explores the Indian policy framework for an SEZ, it further discusses the various incentives available to an SEZ and an SEZ Unit. It also study the recent legal and regulatory developments pertaining to SEZs in India.

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INTRODUCTION

Special Economic Zone (SEZ) is a geographical region that has economic laws that are more liberal than a country's typical economic laws. 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. 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.

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This paper explores the Indian policy framework for an SEZ, it further discusses the various incentives available to an SEZ and an SEZ Unit, and the recent legal and regulatory developments pertaining to SEZs in India.

INDIAN SCENARIO

India is one of the first countries in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports. Asia's first EPZ was set up in Kandla in

1965. With a view to create an environment for achieving rapid growth in exports, a Special Economic Zone policy was announced in the Export and Import (EXIM) Policy 2000. Under this policy, one of the main features is that the designated duty free enclave to be treated as foreign territory only for trade operations and duties and tariffs. No licence required for import. The manufacturing, trading or service activities are allowed.

To provide a stable economic environment for the promotion of Export-import of goods in a quick, efficient and hassle-free manner, Government of India enacted the SEZ Act, this received the assent of the President of India on June 23, 2005. The SEZ Act and the SEZ Rules, 2006 ("SEZ Rules") were notified on February 10, 2006. The SEZ Act is expected to give a big thrust to exports and consequently to the foreign direct investment ("FDI") inflows into India, and is considered to be one of the finest pieces of legislation that may well represent the future of the industrial development strategy in India. The new law is aimed at encouraging public-private partnership to develop world-class infrastructure and attract private investment (domestic and foreign), boosting economic growth, exports and employment.

Considering the need to enhance foreign investment and promote exports from the country and realizing the need that level playing field must be made available to the domestic enterprises and manufacturers to be competitive globally, the Government of India 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. To provide an internationally competitive and hassle free environment for exports, units were allowed be set up in SEZ for manufacture of goods and rendering of services. All the import/export operations of the SEZ units is on self-certification basis. The units in the Zone are required to be a net foreign exchange earner but they would not be subjected to any pre-determined value addition or minimum export performance requirements. Sales in the Domestic Tariff Area by SEZ units are subject to payment of full Custom Duty and as per import policy in force. Further Offshore banking units are being allowed to be set up in the SEZs.

SALIENT FEATURES OF AN SEZ

SEZs are specifically delineated duty-free enclaves and are deemed to be foreign territory for the purposes of trade operations, duties and tariffs. The principal goal is to increase foreign investment. Through the introduction of SEZs, India also wants to enhance its somewhat dismal infrastructural requirements, which, once they have been improved, will invite even more foreign direct investment. Or put in the government's own words, the main objectives of the SEZs 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.

LEGAL FRAMEWORK

The legal framework and the regulatory developments pertaining to SEZs are discussed as under

For a long time, the foreign economic policy was formulated in Para. 7.1 of the Foreign Trade Policy, according to which (1) SEZs are duty-free enclaves within the territory of India, and where (2) goods and services going into an SEZ from a domestic tariff area (DTA) shall be treated as exports, while goods coming from the SEZ area into the DTA shall be treated as if these are imported; and (3) the SEZs may be set up for the manufacture of goods or rendering of services. Since the SEZ Act of 2005 was put into force, these policies have been outlined there. As the Indian government wanted to give a significant thrust to its professed investor-friendly policy, the government enacted the SEZ Act, 2005, which became operative in February 2006 together with the SEZ Rules. The state governments followed suit and also enacted their own SEZ laws to mainly cover state subjects. The SEZ legal framework intends to provide a comprehensive tool to satisfy the requirements of all principal stakeholders in the SEZ: the developer and operator, occupying enterprises, external SEZ suppliers and residents. Furthermore, the SEZ Act is advertised by the Indian government as a single window clearance mechanism in which the responsibility for promoting and ensuring the orderly development of the SEZ is assigned to the Board of Approval (BoA). The Board of Approval was constituted by the Central Government in exercise of the powers conferred under the SEZ Act. All the decisions are taken in the Board of Approval by consensus. The Board of Approval has 19 members (Section 8 SEZ Act). It comprises various joint secretaries and other officials from several ministries, such as the Ministries of Commerce, Economy, Science and Technology, Home Affairs, Defence, Environment, Law, Overseas Affairs, Urban Development and Finance as well as that of a nominee of the state government concerned, a professor at the Indian Institute of Management or the Indian Institute of Foreign Trade. Thus, this Central Government institution is the major authority for applications and approvals regarding the establishment of SEZs. Earlier on, the Central Government wanted to dispense with the right of the states to have a say in the approval procedure. This predictably, on the pressure of the states, had to be revoked, so as to safeguard the support of the left-wing parties in the Indian Parliament, which tolerates the minority coalition government led by the Indian National Congress.

WHO CAN SET UP AN SEZ AND WHAT REQUIREMENTS ARE THERE?

An SEZ can be set up jointly or individually the Central Government, a state government or any other body, including a foreign company, for the purpose of (1) manufacturing goods, (2) rendering services, (3) for both of these reasons or (4) as a Free Trade and Warehousing Zone (FTWZ). The SEZ Rules specify the minimum land area that is required for setting up an SEZ in general. This requirement depends on the type of SEZ to be established:

Table :1

Minimum contiguous area requirements for certain types of SEZs

Type of SEZ Hectares	**Hectares**
Multi-product	1,000 or more
Sector-specific or in one or more services or a port or an airport	100 or more
Sector-specific: electronics hardware or software, IT, gems & jewellery, bio-technology, non-conventional energy, including solar energy equipment and solar cells	10 or more
Free Trade & Warehousing Zone (FTWZ)	40 or more

The requirements concerning the minimum size of an SEZ are relaxed with regard to certain small states. Thus, in the states of Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Manipur, Tripura, Himachal Pradesh, Uttaranchal, Sikkim, Jammu and Kashmir, Goa or in a Union Territory, the minimum area requirement for multi-product SEZs or a sector-specific SEZ has been reduced to 200 and 50 hectares or more respectively. In the case of a multi-product or a sector-specific SEZ, at least 50 per cent of the area must be earmarked for developing the processing area. The very specific requirements for sector-specific operations can be seen from sec. 5 para. 2 lit. b) and c) SEZ Rules. If the developer proposing to set up an SEZ is not in possession of the minimum contiguous area, the Central Government may approve more than one developer. In such cases, each developer shall be considered as a developer in respect of the land under its possession. Whereas, at first, there was no ceiling regarding the maximum size of an SEZ, a meeting of the so called Empowered Group of Ministers (EGoM) held on 5th April 2007 brought about a capping at 5,000 hectares, which can still be undercut by states as land matters are state matters according to Indian constitutional law.

APPROVAL MECHANISM

The developer, which may be the (Central and State) government itself, a private developer or a joint venture in which both parties are involved, is entitled to set up an SEZ after identifying the proposed area. The procedure for setting up a zone like this may vary according to the nature of the developer. The private developer submits his proposal for establishment of an SEZ to the state government concerned. Notwithstanding, the private developer may also approach the BoA directly and thereafter get the concurrence of the state government concerned. The state government has to get its proposal screened directly by the BoA according to SEZ Act. After consulting the respective state government, however, the Central Government may set up and notify the SEZ *suo motu*. The state government has to forward the private developer's proposal to the BoA within 45 days of the date of receipt along with its recommendation. The BoA then has the power of approving or rejecting the proposal or modifying such proposals for the establishment of SEZs. In the event of approval, the BoA communicates the same to the Central Government, which, in turn, grants formal approval to the developer through a Letter of Approval (LoA) within 30 days of receiving the communication from the BoA. The LoA is valid for a period of three years, during which the developer must take all necessary steps to ensure implementation of the approved proposal. The powers also include the decision-taking regarding authorised operations to be carried out in the SEZ by the developer as well as granting approval to the developers or units in the SEZ for foreign collaboration, foreign direct investment and regarding infrastructure facilities. The proposal paths are visualised in Figures 1 and 2:

Figure 1: Approval mechanism for the establishment of an SEZ for a private developer

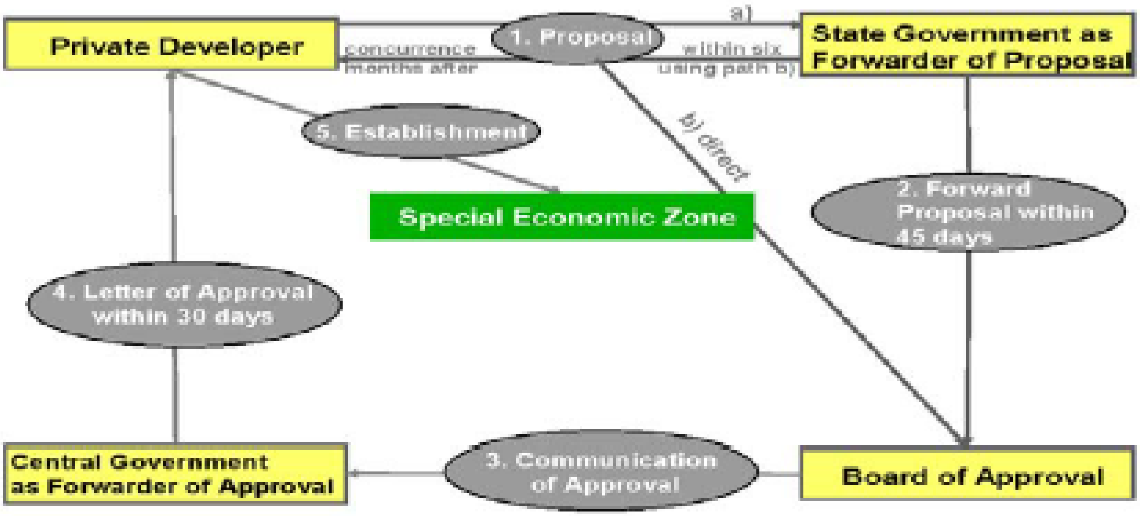

Figure 2: Approval mechanism for the establishment of an SEZ for the Central and state government as a developer

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. With a view to overcome the shortcomings experienced on account of the multiplicity of controls and clearances; absence of world-class infrastructure, and an unstable fiscal regime and with a view to attract larger foreign investments in India, the facts about Special Economic Zones (SEZs) are tabulated in Table II

TABLE : 2

FACT SHEET ON SPECIAL ECONOMIC ZONES IN INDIA

(AS OF 21ST JUNE 2007)

SEZ Act 2005	Passed by Parliament in May 2005 Received Presidential Assent on 23rd June 2005 Came into effect on 10th February 2006
SEZ Rules 2006	Notified by the Central Government on 10th Feb 2006 Amended twice in August 2006 and March 2007
SEZs formally approved:	303
SEZs formally notified:	127
SEZs approved in principle:	161
Land requirement:	For SEZs formally approved: approx. 415 km² For SEZs approved in principle: approx. 1,430 km² 1,845 km² *For reference:* total land in India (excluding the Ocean rim): 2,973,190 km² total agricultural land in India : 1,620,388 km² Chinese SEZ: Shenzhen 327 km² Hainan 34,000 km² Total area proposed for SEZs (approved and approved in principle) not more than 0.062 per cent of the total land area and not more than 0.11 per cent of the total agricultural land in India.
Investment made in 127 notified SEZs:	€6.39 billion (US$7.99 billion)
Employment created in 127 notified SEZs	32,578 persons

Expected investment and employment from SEZs (by December 2009):	127 notified SEZs: investment: €26.99 billion (US$ 33.74 billion) employment: 1.55 million additional jobs If 303 SEZs become operational: investment: €54.54 billion (US$ 68.18 billion) employment: 4 million additional jobs
Exports in the financial year 2006-07	€6.32 billion (US$7.91 billion), €1.69 billion (US$2.11 billion) of which account for new-generation SEZs. This is a growth of 52 per cent over the previous financial year, 2005-2006.
Exports projected by all 146 SEZs (19 old and 127 new ones) in the financial year 2007-2008:	€12.24 billion (US$15.30 billion)

Source: Ministry of Commerce and Industry, Department of Commerce, Government of India as seen on www.sezindia.nic.in.

Some of the important SEZ in India are as follows -

- Karnataka Biotechnology and Information Technology Services - SEZ on biotechnology sector in Bangalore's Electronics City, over an area of 43 acres
- Shree Renuka Sugars Limited - SEZ on sugarcane processing complex covering 100 hectares, comprising a sugar plant, power station and distillery, at Burlatti in Belgaum district
- Ittina Properties Private Limited and three other - SEZs in IT sector, covering electronics, hardware and software sectors in Bangalore, over an area of 15.732 hectares
- Wipro Infotech - SEZ on IT / ITES at Electronics City, Sarajpur Bangalore
- Hewlett Packard India Software Operation Pvt. Ltd. - SEZ on IT
- Food processing and related SEZ services in Hassan, over an area of 157.91 hectares
- SEZs on pharmaceuticals, biotechnology and chemical sectors in Hassan, covering of 281.21 hectares
- SEEPZ - Andheri (East), Mumbai
- Khopata - Multi-product, Mumbai
- Navi Mumbai - Multi-product, Mumbai

- Salt Lake Electronic City, West Bengal
- Manikanchan - Jems and jewelery, West Bengal
- Calcutta Leather Complex, West Bengal
- Falta food processing unit, West Bengal

INCENTIVES / FACILITIES FOR SEZ UNITS

Following incentives/ facilities to SEZ enterprises:

Customs and Excise :

- SEZ units may import or procure from the domestic sources, duty free, all their requirements of capital goods, raw materials, consumables, spares, packing materials, office equipment, DG sets etc. for implementation of their project in the Zone without any licence or specific approval.
- Duty free import/domestic procurement of goods for setting up of SEZ units.
- Goods imported/procured locally duty free could be utilised over the approval period of 5 years.
- Domestic sales by SEZ units will now be exempt from SAD.
- Domestic sale of finished products, by-products on payment of applicable Custom duty.
- Domestic sale rejects and waste and scrap on payment of applicable Custom duty on the transaction value.

Income tax

- Physical export benefit
- 100% IT exemption (10A) for first 5 years and 50% for 2 years thereafter.
- Reinvestment allowance to the extend of 50% of ploughed back profits
  Carry forward of losses

Foreign Direct Investment :

- 100% foreign direct investment is under the automatic route is allowed in manufacturing sector in SEZ units except arms and ammunition, explosive, atomic substance, narcotics and hazardous chemicals, distillation and brewing of alcoholic drinks and cigarettes , cigars and manufactured tobacco substitutes.
- No cap on foreign investments for SSI reserved items.

Banking / Insurance/External Commercial Borrowings:

- Setting up Off-shore Banking Units allowed in SEZs.

- OBU's allowed 100% Income Tax exemption on profit for 3 years and 50 % for next two years.
- External commercial borrowings by units up to $ 500 million a year allowed without any maturity restrictions.
- Freedom to bring in export proceeds without any time limit.
- Flexibility to keep 100% of export proceeds in EEFC account. Freedom to make overseas investment from it.
- Commodity hedging permitted.
- Exemption from interest rate surcharge on import finance.
- SEZ units allowed to 'write-off' unrealized export bills.

Central Sales Tax Act :

- Exemption to sales made from Domestic Tariff Area to SEZ units.

Service Tax:

- Exemption from Service Tax to SEZ units

Environment :

- SEZs permitted to have non-polluting industries in IT and facilities like golf courses, desalination plants, hotels and non-polluting service industries in the Coastal Regulation Zone area
- Exemption from public hearing under Environment Impact Assessment Notification

Companies Act :

- Enhanced limit of Rs. 2.4 crores per annum allowed for managerial remuneration
- Agreement to opening of Regional office of Registrar of Companies in SEZs. Exemption from requirement of domicile in India for 12 months prior to appointment as Director.

Drugs and Cosmetics :

- Exemption from port restriction under Drugs & Cosmetics Rules.

Sub-Contracting/Contract Farming :

- SEZ units may sub-contract part of production or production process through units in the Domestic Traiff Area or through other EOU/SEZ units
- SEZ units may also sub-contract part of their production process abroad.
- Agriculture/Horticulture processing SEZ units allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the requirement of importing countries.

CONCLUSION

Many experts have expressed concerns over the philosophy of sops boost exports. But, now, however government seems to be realizing the need for formulating a new Indian model of SEZ. India has in fact, the right mix of factors such as availability of large & skilled workforce, intrinsic comparative advantage in several industries, a strong policy framework, availability of complementing & supporting ancillary industry, an already buoyant export sector & vast local markets. SEZs can combine these factors into a powerful alchemy to power investment creation. Unless remedies can be found out to loosen prevalent rigid labour laws, the SEZs cannot be looked at as a panacea for all economic diseases.

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