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SEZ: A Tool of Multiplier of GDP

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Abstract

Facilitating international trade for the sustained growth of the economy and increased contribution to the GDP of the nation is need of hours for developing countries. A Special Economic Zone ("SEZ") is a specified, delineated and duty-free geographical region that has different economic laws from those of the country in which it is situated. 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. Government of India is providing several incentives and infrastructural facilities to manufacturing sector and services sector to boots foreign trade and encourage economic activities in domestic market. Successful SEZs create new jobs for citizens, provide laboratories for governments to run controlled trade policy experiments, attract FDI, strengthen industries, and help countries avoid potentially defective domestic laws and institutions that act as a barrier to growth. This paper is about contribution of SEZ in the economics growth and development of the Economy.

Key words:

International trade, Special Economic Zone, Foreign Investment, Incentives.

Introduction

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. The SEZ's are important in today's context for the third world countries which have been in the race for rapid economic growth. In India, SEZs have played an important role in facilitating exports, thereby enabling the country to be a part of globalization. SEZs attract investment and foreign exchange, spur employment and boost the development of improved technologies and infrastructure. It will increase flow of foreign and domestic investment, infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities. 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. According to the latest SEZ Fact Sheet available, formal approval has been issued to 416 SEZs, out of which 329 SEZs are notified. 205 SEZs are operational and 4,127 units are operating in these SEZs. A total investment of INR 3,73,445.83 crore has been made in these SEZs and they employ 15,56,537 persons. Exports from these SEZs stood at INR 4,94,077 crore in 2013-14, INR 4,63,770 Crore in 2014-15 and INR 3,41,685 crore in 2015-16 (As on 31st December, 2015).(http://www.mondaq.com)

Evolution of the EPZ Policy in India

The first zone was set up in 1965. The country has had four phases in the evolution of the EPZ policy since then. Following is a brief overview of the evolution of the EPZ policy in India through these four phases.

1. **Initial Phase: 1965-1985**- The first zone was set up in Kandla in a highly backward region of Kutchh in Gujrat as early as in 1965. It was followed by the Santacruz export processing zone in Mumbai which came into operation in 1973. There was however no clarity of objectives that the government wanted to achieve. Kandla and Santacruz EPZs were set up with different sets of objectives (Tondon Committee, 1980). Operationally, an overall inward looking trade policy with umpteen controls and regulations influenced the EPZ policy also (Kundra 2000). In 1980 the government introduced the Export Oriented Units Scheme (EOU). This scheme facilitates the setting up of EOUs beyond the boundaries of EPZs. The responsibility of administering these units was also entrusted with the zone administration.
2. **Expansionary Phase: 1985-1991-** Towards the end of the 1970s, India's failure to step up significantly the volume of her manufactured exports in the background of the Second Oil Price Shock began to worry the policy makers. To provide fillip to exports, the government decided to establish four more zones in 1984. These were at Noida (Uttar

Pradesh), Falta (West Bengal) Cochin (Kerala) and Chennai (Tamil Nadu). Thereafter, Visakhapatnam EPZ in Andhra Pradesh was established in 1989, though it could not become operational before 1994. All these zones with the exception of Chennai were set up in industrially backward regions. The primary objectives of the zones were still not specified and there were no significant changes in other laws and procedures pertaining to the EPZs.

3. **Consolidating Phase: 1991-2000**
   In 1991, a massive dose of liberalization was administered in the Indian economy. In this context, wide-ranging measures were initiated by the government for revamping and restructuring EPZs also This phase was thus marked byprogressive liberalisation of policy provisions and relaxation in the severity of controls and simplification of procedures. The focus had been on delegating powers to zone authorities,providing additional fiscal incentives, simplifying policy provisions and providing greaterfacilities. The scope and coverage of the EPZ/EOU scheme was enlarged in 1992 by permittingthe agriculture, horticulture and aqua culture sector unit also. In 1994, trading, re-engineeringand re-conditioning units were also permitted to be set up.

4. **Emergence Phase : 2000 onwards**
   This period has witnessed a major shift in direction, thrust and approach. The EXIM Policy (1997-2002) has introduced a new scheme from April 1, 2000 for establishment of the Special Economic Zones (SEZs) in different parts of the country. SEZ is an almost self contained area with high class infrastructure for commercial as well as residential inhabitation. SEZs are permitted to be set up in the public, private, joint sector or by the State Governments with a minimum size of not less than 1000 hectares. The number of incentives both fiscal and non fiscal has also been extended to the units operating in SEZs. Several measures have been adopted to improve the quality of governance of the zones. These include relaxation in the conditions for approval process and simplifying custom rules. More recently, Development Commissioners are given the labour commissioner's powers. SEZ policy is thus the most significant thrust towards ensuring the success of export processing zones.

From November 1, 2000 the Export Processing Zones at Kandla, Santa Cruz (Mumbai),Cochin and Surat have been converted into SEZs. In 2003, other existing EPZs namely, Noida, Falta, Chennai, Vizag were also converted into SEZs. In addition, approval has been given forthe setting up of 26 SEZs in various parts of the country in the private/JT sectors or by the state.The include, SEZs at Nanguneri (Tamil Nadu), Positra (Gujarat), Kulpi (West Bengal), Paradeep (Orissa), Bhadohi and Kanpur (Uttar Pradesh), Kakinada (Andhra Pradesh), Dronagiri (Maharashtra) and Indore (Madhya Pradesh). Besides, Santacruz EPZ was also extended in terms of size by adding 11 acres. Introduction of the SEZ policy has marked the period of emergence of the EPZ policy in India. It is expected to go a long way in determining the success of the EPZs (now called SEZs) in India

Overview of SEZs

Special Economic Zones (SEZs) are specially earmarked geographical zones, which can be developed by a private sector or public sector developer or in a public private partnership (PPP) model. In these zones, units function under rules and regulations different from those under which other units in the country operate. The units in the SEZs have to be net foreign-exchange earners but they are not subjected to pre-determined value addition or asked to fulfill minimum export performance requirements. Approved industrial units, banks, insurance, etc., can be located here. SEZs in India are modified versions of the earlier export processing zones. The policy to set up SEZs, first introduced in April 2000, got a legal validity with the SEZ Act passed in 2005. The Act came into force on February 9, 2006.A state can have more than one SEZ with freedom to the manufacturing unit to establish in any SEZ in any state. State governments will have to attract industry by framing bold policies and providing world-class external infrastructure to the zone.

The primary objectives are as follows.

- To provide foreign exchange earnings by promoting non-traditional exports
- To provide jobs to alleviate unemployment or under-employment problems in the country and assist in income creation.
- To attract foreign direct investment (FDI) and engender technological transfer, knowledge spill-over and demonstration effects that would act as catalysts for domestic entrepreneurs to engage in production of non-traditional products.
- To attract export-oriented foreign direct investment and develop industrial skills and resources to successfully compete in the international economy.
- To create employment and to develop relatively less developed areas by reducing disparities in socio-economic development, besides accelerating industrialization and urbanization.

Main Features

1. Unlimited, duty-free imports of raw, intermediate input and capital goods necessary for the production of exports.
2. Less governmental red-tape. More flexibility with labor laws for the firms in the zone than in the domestic market.
3. Generous and long-term tax holidays and concessions to the firms.
4. Above average (compared to the rest of the host country) communications services and infrastructure. It is also common to for countries to subsidize utilities and rental rates.
5. Zone firms can be domestic, international or joint venture. The role of FDI is prominent in EPZ activities.
6. Zones can be categorized into public or private zones (owned or managed), and high-end or low-end.

Significance of SEZ in the economy

The SEZs provide facilities to help support production units which can match the international level in quality. The SEZ helps to boosting a country's exports tremendously. They promote economic activity through backward and forward linkages with domestic economies and aid in development of technological and learning spillovers. The world-class infrastructure set up will cut down the cost of conducting business and render the industry competitive globally. The infrastructure will include electricity availability at competitive rates, capital availability at internationally benchmarked rates, good transport links to check shipment delays and flexible labour laws.

Government needs huge amount of funds for growth and massive development program. By setting up an SEZ, the government may tie up with private partners who are willing to invest in that area. Government gets the capital needed to establish the required infrastructure and also the expertise. The private player on the other hand gets the right to market and use the SEZ's with relaxed tax laws, thereby increasing its revenue generating capacity and also carrying out the economic growth of the company in a more efficient way with the better tax policies .

SEZ's create immense employment opportunities. The setting up of SEZ's creates lot of indirect employment in terms of labour required. Then after the completion it enables employment in the relevant industries operating in the SEZ. Then there are lots of indirect employments generated wherein people start investing around SEZ. For example SEZ's are townships of their own; thereby there are shopping malls, restaurants, amusement parks setup around to attract people, thus resulting in more economic development in that area.

SEZ's improve the country's foreign export. Because of the increased FDI and Private Equity presence, the local manufacturers get to tie up with these big names and export their products which now carry a better brand value, therefore helping in creating a greater demand for the goods of local manufacturers. Moreover the massive capital required for expansion is brought in form of FDI resulting in increased economic activity. The increased exports from the country bring in more revenue for the country which improves the economic growth.
SEZ's help in creating a balanced economic growth in a country if they are properly located and implemented leading to tapping of local talent and contributing to increased economic activity in the area.

Measure to promote SEZs

Various measures are being adopted to promote export competitiveness by governments. In this scenario, SEZs have become rather popular trade policy instruments due to their catalytic role in imparting outward orientation to the economies. Several measures have been adopted to improve the quality of governance of the zones.

All proposals which do not meet any or all of the parameters for automatic approval will be considered and approved by the Board of Approval of EOU/EPZ/SEZ set up in the Department of Commerce. Proposals not covered under the automatic route would be considered and approved by FIPB. There would be no routine examination of export and import cargo by Customs and all imports would be on self certification basis and no separate documentation is required for customs and EXIM Policy. The number of incentives has also been extended to the units operating in SEZs. These include fiscal and non fiscal incentives.

Non fiscal incentives

1. Exemption from industrial licensing for manufacture of items reserved for SSIs
2. 100 per cent FDI investment through automatic route to manufacturing SEZ units (barring a handful of sensitive industries .
3. FDI upto 100% is allowed for: the ISPs not providing gateways (both for satellite and submarine cables), Infrastructure Providers providing dark fibre (IP Category I), electronic Mail and Voice Mail in the telecom sector
4. Facility to retain 100% foreign exchange receipts in EEFC Account Facility to realize and repatriate export proceeds within 12 months.
5. No cap on foreign investment for SSI reserved items.
6. Re-export of imported goods found defective, goods imported from foreign suppliers on loan basis etc. without G.R. Waiver under intimation to the Development Commissioner.
7. "Write-off" of unrealized export bills upto 5%.
8. Commodity hedging by SEZ units permitted
9. Capitalization of import payables
10. Profits allowed to be repatriated freely without any dividend balancing requirement.
11. No fixed wastage norms.
12. Full freedom for subcontracting including subcontracting abroad.
13. Subcontracting facility available to jewellery units.
14. Duty free goods to be utilized in 5 years.

Fiscal incentives

1. 100% income tax exemption for a block of five years,50% tax exemptions for two years and upto 50% of the Profits ploughed back for next 3 years under section 10-A of Income tax Act.
2. Supplies from DTA to SEZ to be treated as exports under 80HHC of the IT Act.
3. Carry forward of losses
4. 100% Income-tax exemption for 3 years & 50% for 2 years under section 80-LA of the Income-tax Act for off-shore banking units.
5. Exemption from Central Excise duty on procurement of capital goods, raw materials, consumable spares etc. from the domestic market.
6. Reimbursement of Central Sales Tax paid on domestic purchases.

Policy guidelines for establishing SEZs

1. **General economic environment :**Sound and stable monetary and fiscal policies (low inflation, budget management, independent monetary policy), clear private property and investment laws provide a general environment propitious for SEZs .

2. **Taxation and tariff structure:** Moderate income and corporate tax rates are recommended. There is no need for "overly friendly tax incentives (such as permanent tax holidays or waiving all taxes). Provide for accelerated depreciation, rationalize and minimize indirect taxation and licensing practices. Improved collection rates can partially compensate for potential revenue due to reduced tax rates.

3. **Provision of infrastructure and subsidized utilities:** Private development and management of EPZs, including on-site infrastructure (pavements, building shells, etc.) Provision of infrastructure external to the zone proper can have positive spillovers for the local and national economy by facilitating transportation and communications (telephones, roads, ports and airports.

4. **Labor rights, wages and workers safety**: Labor market constraints increase labor costs and slow market adjustment. So business friendly labor laws are beneficial. But, this need not be accompanied by disregard or abuse of workers' safety and labor rights as is the case in some zones. Strengthening regulatory and monitoring activities will reduce labor turn-over and absenteeism and improving workers' productivity.

5. **Environmental issues**: Most developing countries have lax laws and implementation. Concern exit regarding the SEZs large production volume -and its potential pollution level- compared to the host economy production levels. In this area, a first necessary step is to form a better qualitative and quantitative understanding of these industrial refuses and their impact on air, soil, water and human health. Follow-up regulation, provision of incentives and monitoring should be tailored accordingly.

Challenges before SEZ policy

1. 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.
2. SEZ's are leading to decrease in crop production thus slowing down of agricultural activity in the country.
3. More and more farmers are moving towards the lucrative manufacturing side in search of greater economic security.
4. Arable land is being used for non agricultural purpose which could lead to food crisis and loss of self sustenance in future.
5. The SEZ's if not properly located could lead to Supply Chain Management problems as well.
6. Improper planning could lead to unbalanced growth in the region
7. SEZ's could also lead to income disparities with divide between the rich and poor increasing if not properly planned.

8. The measures should be taken to make surroundings livable for multitude of people living in the SEZ's.
9. Care should be taken to properly treat effluents from industries not to affect surrounding rivers.
10. SEZ's should be carefully planned not to affect the natural habitat.

Conclusion

In India the policies for setting up SEZ was introduced on April 1, 2000 with a view to provide an internationally competitive and hassle free environment for exports. The policy offered setting up of SEZ in the public, private, joint sector or by State Governments. The SEZ's could drastically improve the economic activity in the country, make the country's export competitive and globally noticeable, be net foreign exchange earner and provide immense employment opportunity. 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. The onus to ensure that fertile land is not notified for industrialization should be on respective state governments. They should also ensure that such projects are limited to barren and wasteland. In the present scenario, it cannot be ruled out that agriculture is still the source of sustenance for most Indian families.

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