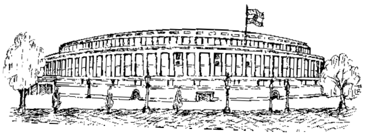
Issues for Parliamentarians

To facilitate informed discussions among Indian Parliamentarians on key economic policy issues

25 years 1983 2008 CUTS International

2 / 2007

Good Economics is Good Politics



Parliamentarians' Forum on Economic Policy Issues (PAR-FORE)

Special Economic Zones (SEZs) in India

BACKGROUND

The first ever major policy announcement made by the Government of India was the Industrial Policy Resolution of 1948. This policy adopted an import substitution industrialisation strategy across all sectors for rapid economic development of the country. However, within this strategy it was well recognised that efforts would be made towards export promotion. This strategy received further boost during the implementation of the 2nd and 3rd Five Year Plans of India – from mid-1950s to mid-1960s. Though the Government did not do anything substantial for promoting exports (particularly manufacturing exports) during this period some discrete and piecemeal policy steps were taken when Kandla (Gujarat) Export Processing Zone (EPZ) was established in 1965 with the provision of better infrastructure and tax holidays.

SEZ POLICY IN INDIA

Between 1965 and 1990, seven EPZs were set up. It is interesting to note that though India started pursuing economic reforms in early 1990s, no new EPZs were established during the decade. However, a number of provisions (either new or revised) have been made for better functioning of the EPZs.

In principle, SEZs have played a vital role in promoting exports, generating employment as well as ensuring overall development of an economy. Though known by different names, SEZs exist in many countries – not only in the developing world but also in rich countries such as the US. With the establishment of Kandla EPZ in 1965, India became the first country in Asia to create such zones.

The Export-Import (EXIM) Policy of 1997-2002 introduced a more comprehensive and liberal concept to establish SEZs. While correcting the shortcomings of the EPZ model, some new features were incorporated in the SEZ Policy announced in April 2000, which intended to make SEZs an engine for economic growth supported by quality infrastructure and complemented by an attractive fiscal package – both at the Centre and the States – with the minimum possible regulations. Private sector was allowed to play a more active role in developing SEZs with or without government participation.

During 2000-05, approvals were given to set up 26 SEZs. Interestingly, most of these SEZs were in the nature of a joint venture between State Government and a private party. In order to impart stability to the SEZ policy regime and to generate

Box 1: Success of Chinese SEZs

The development of Special Economic Zones (SEZs) in the past 20-odd years is one of the highlights of remarkable Chinese economic achievements. In China, SEZs and Economic and Technological Development Zones (ETDZs) have become new economic platforms. For the last two decades, the major economic indices showed rapid increases. For example, in 2002, 49 National Economic and Technological Development Zones (NETDZs) of China scored a gross domestic product (GDP) of US$40bn, up by 29.4 percent than 2001; industrial value added of US$28bn (accounting for 71 percent of GDP), up by 28.3 percent; total industrial output of US$100bn, up by 25.5 percent; tax revenue of US$6.2bn, up by 23.1 percent; foreign trade value of US$53.6bn, up by 36 percent, of which export composed US$27.5bn, up by 33.8 percent, contractual foreign investment of US$15bn, up by31 percent, actually-utilised foreign investment of US$7.7bn, up by 23.4 percent etc.

more economic activity and employment through exports, the SEZ Act, 2005 was enacted and associated rules and regulations were notified in February 2006. The main objectives of the SEZ Act, 2005 include:

- promotion of investment from domestic and foreign sources;
- development of infrastructure facilities;
- creation of employment opportunities; and
- promotion of exports of goods and services.

Export performance of EPZs/SEZs in India has shown steady rise, including acceleration since the year 2000. From a mere 0.027 percent in 1966-70, the share of exports from SEZs in total exports has increased to 5.01 percent in 2005-06. Employment growth has more than doubled since 2000. In 2006, private investment in SEZs was about Rs 2,235 crores, of which the foreign component was about Rs 600 crores.

Box 2: What is SEZ?

SEZ/EPZ, as defined by the World Bank and the United Nations Industrial Development Organisation (UNIDO), is an industrial area that constitutes an enclave with regard to customs tariffs and the commercial code in force in the host country and are intended to provide an internationally competitive duty-free environment and quality infrastructure for the promotion of exports at a lower cost.

The Department of Commerce expects that by the year 2009 total investment in SEZs would be Rs 60,000 crores and one million additional jobs will be created. If all the formally approved 362 SEZs become operational, then investment would be Rs 300,000 crores and four million additional jobs will be created. Exports from the operational SEZs stood at Rs 34,787 crores (Rs 9301 crores from the new generation SEZs), in 2006-07 up by 52 percent over 2005-06. Exports projected by all 151 SEZs (19 old and 132 new) in 2007-08 stands at Rs 67,088 crores, which is expected to reach Rs 100,000 crores by 2008-09.

Despite the fact that the objectives of creating SEZs in India are laudable, it has become a debatable issue in the domain of policy making and implementation. While fiscal incentive (and associated loss of possible government revenue) is an issue, there are other issues as well, such as methods and associated matters with land acquisition, the nature of land use pattern etc.

This is because while the Central Government has laid down the overall policy and attendant rules and regulations, it is the responsibility of the State Governments to implement them – in other words, identification of investors (including for joint venture), selecting the type of manufacturing and location of an unit, and ensuring land use pattern, etc. The present position relating to various aspects of SEZs is given in Table 1.

ISSUES ON SEZs IN INDIA

The debate around the setting up of SEZs in India is centred on the five issues:

- loss of government revenue;
- decline in agriculture and associated livelihood opportunities;
- uneven regional development;
- misuse of land for real estate; and
- discrimination against existing industrial units.

In the midst of the controversy over the revenue loss owing to exemptions given to the SEZs, be it by the Ministry of Finance projections of Rs 175,000 crore during the next five years (2005-10) supported by the National Institute of Public Finance and Policy (NIPFP) or the Ministry of Commerce assessment of only Rs 33,065 crore or New Delhi-based Indian Council for Research on International Economic Relations (ICRIER) study's estimates of Rs 19,429 crore to Rs 24,261 crore, let us not fall into the trap of numbers as no two economists will ever agree on the assumptions made by either of them. The fact remains that nobody has ever questioned the merits of SEZs or its economic potential. And there is a broad political consensus in the country that the SEZ policy is here to stay for good.

Turning to the question of land acquisition, which has been highlighted by the Nandigram and Singur episodes, one can strongly argue that land (even agricultural land) has to be acquired for setting up industries, and land-use change does happen. Land acquisition is a state subject. Unfortunately, liberalisation process in the country has not been matched with reform in the rent-seeking *patwari system* of the states. Girish Sanghi, a Member of Parliament (MP) and industrialist, has argued at a PARFORE meeting of parliamentarians in New Delhi, on May 03, 2007, that once the SEZ application is approved by the Board of Approval, on the basis of a State Government recommendation, why should there be any administrative/legal requirements of land conversion for SEZ?

Table 1: Fact Sheet on SEZs (As on July 23, 2007)	
Spesial Economic Zones Act, 2005	Passed by Parliament in May 2005 Received Presidential assent on June 23, 2005 Came into effect on February 10, 2006 supported by the SEZ Rules
Number of formal approvals	362
Number of notified SEZs	132
Number of in-principle approvals	177
Investment made in 132 notified SEZs	Rs 43,123 crores
Employment created in 132 notified SEZs	35053 persons (direct employment)
Expected investment and employment from SEZs (by December 2009)	At the 132 notified SEZs as on June 30, 2007: • Investment: Rs 2,59, 159 crores • Employment: 17,43,530 additional jobs (direct employment)
If 362 SEZs becomes operational:	Investment: Rs 3,00,000 crores Employment: 4 million additional jobs (direct employment)
Exports in 2006-07	Rs 34,787 crores (Rs 9301 crores by New Generation SEZs) Growth of 52 percent over Rs 22840 crores in 2005-06
Exports projected by all 151 SEZs (19 Old + 132 New) in 2007-08	Rs 67,088 Crores 200 percent increase in two years Exports from SEZs likely to cross Rs 100,000 crores by 2008-09
Source: Department of Commerce, Government of India	

His own SEZ venture has got stuck due to this anomaly.

Almost all state industrial development corporations have been/are acquiring lands for either setting up industries by themselves (lately this trend has ceased owing to liberalisation) or selling/leasing out to private entrepreneurs. According to the Commerce Department, only 0.000012 percent of cultivable land will be used for establishing SEZs. Following the land-acquisition related controversies, an Empowered Group of Ministers (EGoM) has decided that State Governments would not buy land for private entrepreneurs and that they would acquire only barren/wastelands or single crop lands for SEZs directly. There is now a consensus across political parties and civil society organisations (CSOs)/non-governmental organisations (NGOs), on acquisition/buying of agricultural land by private SEZs developers, albeit on market prices. On the crucial issue of rehabilitation of landowners, another government policy is in the process of ensuring that the dispossessed are suitably compensated and assure livelihood as will.

Demolishing the sentimental argument of farmers in love with their land, Sharad Joshi, MP observed at the PARFORE meeting that in today's changed circumstances they are ready to sell it for their own betterment. Given the option to sell their land, (obviously at the ruling market prices) which amounts to voluntary retirement from farming and by employing them in industrial activities in SEZs, they will have a better livelihood option. The Nobel Laureate, Amartya Sen emphatically said, "prohibiting the use of agricultural land for industries is ultimately self-defeating".

One innovative way to deal with rehabilitation came up in the case of the JSW Steel plant in Salboni, West Bengal, where farmers were compensated with cash, shares in the company, as well as one assured job to each family. Even if the land-owning company fails, the landowner has received the market price for his land.

The new generation SEZs, such as at Chennai, Sriperumbudur, Hassan, Bangalore, Manikanchan etc., have created a tremendous local area impact in terms of direct employment to semi-skilled, formal and informal activities, consumption pattern and social life in and around SEZs. The level of education is rising, including female education. Wage rates are increasing and are higher in SEZs as against outside. The HSL SEZ at Hassan (Karnataka) has recruited mostly women. It has so far employed approximately 1,700 women from the nearby villages. Prior to the establishment of the Gems and Jewellery SEZ in Manikanchan, artisans used to migrate to Gujarat and its neighbouring states in search of employment, but now they are reverting to West Bengal. One has to visit these SEZs to see the energy and vibrancy of the situation.

One crucial issue, which will come up in future, is of competitiveness of industrial units outside the SEZs, which are clearly disadvantaged with the ones that operate there. Industrial units operating in concessional areas in Himachal or Uttaranchal are better off than their competitors in traditional areas. This gap needs to be studied and addressed in future strategies otherwise India will face new problems.

In conclusion, the imperatives of SEZs in present context are hardly disfavoured but some caveats are to be well recognised. There may be a potential threat of land being used for real estate purposes, as opined by Rahul Bajaj another parliamentarian-business tycoon. At the same PARFORE meeting, Bajaj said that larger non-processing area will attract developers of SEZs for the development of shopping malls, recreational facilities, even golf courses etc. This, among others, is the concern, which needs to be tackled head on for realising the potential benefits of SEZs.

REQUIRED POLICY OPTIONS

Following are some of the pertinent policy issues, which need serious attention of the policy makers for making SEZs serve the purpose for which they have been/are established:

- Ensuring that land acquisition has to have a proper and effective policy of rehabilitation and resettlement and the landowners are compensated as per the market prices.
- Ensuring that only waste and barren single crop agricultural land alone is acquired for SEZs and the State Governments should intervene only in the interests of the society at large.
- Addressing the issue of misuse of acquired/purchased lands for real estate business.
- Evolving a suitable policy instrument to provide level playing field to well performing old industrial units set up well before the SEZ Policy came into being so that they are also able to compete with new units coming into SEZs.
- Instituting a suitable mechanism for appointment of zone officials including the development commissioners and better coordination/cooperation between the zone officials and the promoters/unit holders.
- Enhancing capacity building of zone officials and unit holders to optimise benefits of the policy.
- Increasing awareness of all stakeholders and general pubic about likely benefits and costs of SEZs Policy.

ISSUES FOR DISCUSSION

- How are the land acquisition issues settled through (yet to be announced) rehabilitation and resettlement policy and how to ensure the landowners a market price for their surrendered lands?
- What should be the maximum number of SEZs to be established in the country, along with the number of Information Technology (IT) & Information Technology Enabled Services (ITES) SEZs?
- How to enhance public awareness about the pros and cons of SEZ policy as much of the public debate suffers from mis information and rumours?
- How to make a rational assessment of the revenue losses due to tax concessions, as both Ministry of Finance and the Ministry of Commerce have different views?
- Should the size of SEZ be sufficiently large (like those in China)? Or “small and many” policy (followed by India) against “large and few” policy (followed by China)?
- What mechanism can effectively curb the tendency of promoters to from SEZs into a real estate business?

For further information, please contact

D-217, Bhaskar Marg, Bani Park,
Jaipur 302 016, India.
Ph: 91.141.228 2821
Fx: 91.141.228 2485
E-mail: c-cier@cuts.org
Web Site: www.cuts-international.org
Printed by Jaipur Printers Pvt. Ltd.,
M. I. Road, Jaipur
To post comments, please write to:
PAR-FORE@yahoogroups.com