

Performance Appraisal of SEZ in India

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Abstract

The creation of SEZ and its contribution in the development of economy of the country is a burning topic which is directly or indirectly related to the social, psychological and economic aspects of the country. In the present paper "Performance Appraisal of SEZ in India", an attempt is made to critical examine the elements of SEZ. The SEZ policy continues to be relevant from a Make in India perspective but several policy initiatives are necessary to get those going. Manufacturers should be allowed to sell goods in the domestic market but duty should be imposed on individual parts imported and not on the entire product, which would make it unviable. The present study "Performance Appraisal of SEZ in India" is the need of the hour as high priority and aspirant scheme of "Make in India" is executed by PM Modi. SEZ has been assumed as 'engine of growth'. But, it could not perform as thought upon earlier.

Key Words : SEZ, EPZ, Performance Appraisal, India.

1. INTRODUCTION

To boost exports and impressed by the success of Chinese Special Economic Zone (SEZs), the Government of India replaced the Export Processing Zone (EPZ) scheme with the "SEZ scheme" in 2000. There is a handsome difference between an SEZ and EPZ. The former is an integrated township with fully developed infrastructure whereas an EPZ is just an industrial enclave. In order to provide a significant thrust to the policy, the government enacted the SEZ Act 2005. The act became operative in February 2006 after the SEZ rules were framed and notified. Moreover, state governments also

enacted their own SEZ laws, primarily to cover state subjects.

An important feature of the Act is that it provides a comprehensive SEZ policy framework to satisfy the requirements of all principal stakeholders in an SEZ– the developer and operator, occupant enterprise, out zone supplier and residents. Earlier, the policy relating to the EPZs/SEZs was contained in the Foreign Trade Policy while incentives and other facilities offered to the SEZ developer and units were implemented through various notifications and circulars issued by the concerned ministries/departments. Another major feature of the Act is that it claims to provide expeditious and single window clearance mechanisms. The responsibility for promoting and ensuring orderly development of SEZs is assigned to the board of approval. It is to be constituted by the central government. While the central government may suo motu set up a zone, proposals of the state

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governments and private developers are to be screened and approved by the board. At the zone level, approval committees are constituted to approve/reject/modify proposals for setting up SEZ units. In addition, the Development Commissioner (DC) and his/her office is responsible for exercising administrative control over a zone. The labour commissioner's powers are also delegated to the DC. Finally, clause 23 requires that designated courts will be set up by the state governments to try all suits of a civil nature and notified offences committed in the SEZs. Affected parties may appeal to high courts against the orders of the designated courts.

The Act offers a highly attractive fiscal incentive package, which ensures (i) exemption from custom duties, central excise duties, service tax, central sales taxes and securities transaction tax to both the developers and the units; (ii) tax holidays for 15 years (currently the units enjoy a seven year tax holiday), i.e., 100 per cent tax exemption for 5 years, 50 per cent for the next five years, and 50 per cent of the ploughed back export profits for the next five years; and (iii) 100 per cent income tax exemption for 10 years in a block period of 15 years for SEZ developers.

However, the performance of SEZs could not match the expectations. It was argued that the existing zones could not succeed in attracting investment because of the lack of government commitment to the programme, piecemeal reforms (gradual reforms because of budgetary constraints) policy reversals, poor site selection, and failure to provide world class infrastructure, weak incentives and poor regulation of the zones. Red tape, bureaucratic administrative procedures, rigid labour laws and poor infrastructure are believed to have affected the investment climate adversely in the manufacturing sector in India. Consequently, the government reverted to EPZs with the expectation that if they could effectively be separated from the rest of the economy then they could sustain the manufacturing sector as “engine of growth” for Indian Economy.

This system did not give confidence to investors to commit substantial funds for development of infrastructure and for setting up units.

The Life Cycle of SEZ

A stepwise short reference to the setting up of SEZ is given here as under:

- (a) Anybody who wishes to develop a SEZ submits a proposal to the Board of Approval (BoA). A Single Window approval mechanism has been provided through a 19 member inter ministerial Board of Approval (BoA), headed by the Secretary, Department of Commerce.
- (b) The BoA then grants an 'in-principle' or a 'formal' approval.
- (c) The Central Government issues a notification when the developer proves the possession, contiguity and irrevocable rights on Land. These are called 'Notified SEZs'
- (d) BoA allows the Developer for authorised operation. The SEZs that start operations are called 'Operational SEZs'
- (e) Developer/Units are allowed various Tax Concessions/exemptions for effecting Exports

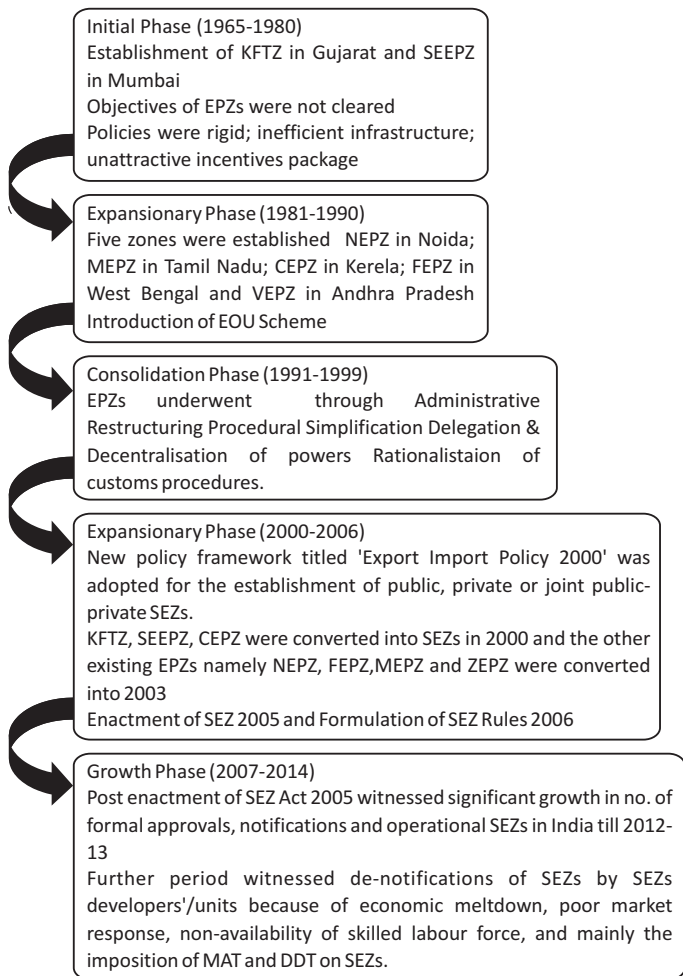
Table 1
State-wise distribution of approved SEZs
(As on 1st May, 2017)

| 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 | 30 | 4 | 25 | 20 |
| Chandigarh | 2 | 0 | 2 | 2 |
| Chhattisgarh | 2 | 1 | 1 | 1 |
| Delhi | 2 | 0 | 0 | 0 |
| Goa | 7 | 0 | 3 | 0 |
| Gujarat | 28 | 4 | 24 | 19 |
| Haryana | 23 | 3 | 20 | 7 |
| Jharkhand | 1 | 0 | 1 | 0 |
| Karnataka | 62 | 0 | 48 | 26 |
| Kerala | 29 | 0 | 25 | 19 |
| Madhya Pradesh | 10 | 0 | 5 | 2 |
| Maharashtra | 55 | 12 | 48 | 28 |

| | | | | |
|--------------------|------------|-----------|------------|------------|
| Manipur | 1 | 0 | 1 | 0 |
| Nagaland | 2 | 0 | 2 | 0 |
| Odisha | 7 | 0 | 5 | 3 |
| Puducherry | 1 | 1 | 0 | 0 |
| Punjab | 5 | 0 | 3 | 3 |
| Rajasthan | 9 | 1 | 8 | 4 |
| Tamil Nadu | 49 | 4 | 47 | 36 |
| Telangana | 65 | 0 | 53 | 29 |
| Uttar Pradesh | 24 | 1 | 19 | 12 |
| West Bengal | 7 | 2 | 5 | 7 |
| GRAND TOTAL | 421 | 33 | 345 | 218 |

Data Source : www.sezindia.nic.in.

Figure 1
Chronological History of SEZ



Source : www.sezindia.nic.in

2. METHODOLOGY AND OBJECTIVES

The present study is an attempt to determine the efficacy of SEZs in India from the perspectives of developers/units. For this, data are collected through secondary sources.

Objectives

The major objectives of the present study are –

- (i) to analyze the current status and performance of SEZs in India in terms of investments, employment and exports;
- (ii) to analyse the overall efficacy of the functioning and monitoring of SEZs in India, and
- (iii) to suggest measures to address the concerns of SEZs in India.

The present study “Performance Appraisal of SEZ in India” is the need of the hour as high priority and aspirant scheme of “Make in India” is executed by PM Modi. SEZ has been assumed as 'engine of growth'. But, it could not perform as it was thought upon earlier.

3. PERFORMANCE APPRAISAL : THE DEBATE

The SEZ policy has become again the most rigorous debate in recent years. There has been a mordacious campaign against SEZs by politicians, scholars, media and civil society. Of much more concern however is the fact that there are differences within the government too. The advocates of the policy led by the Ministry of Commerce have however strongly defended the policy. Though the ministry of commerce has attempted to dispel the criticism of the SEZ policy, the fact remains that the SEZ Act was framed without giving adequate thought to most of the ancillary issues. No exercise was undertaken to ensure that legal institutions are in place for massive land acquisition. No long-term strategy was drawn to counter the socio-economic consequences of the scheme.

Every coin has two sides positive as well as negative, but looking deeply into the picture of SEZ presents a gloomy side more. As a backlash of seizure of agriculture land and providing a number of incentives, various incidents have spurred

touching the economy from social, psychological as well as economic aspect. A report on the Export Processing Zones by the Comptroller and Auditor General of India (CAG) had highlighted that Government had to earn foreign exchange and we are foregoing valuable amount of customs duty.

In a country with 65 per cent of the population depending upon agriculture as a means of livelihood, industry ought to be complementary to agriculture. However, industry is being promoted at the cost of agriculture. Even amid heavy criticism of the policy, no serious research has been conducted on how SEZs will affect the regional economy, how much fertile land will actually be lost, how many farmers will be affected and what the tax implications of SEZs will be. Most arguments are based on the perception of officials. There is therefore an urgent need to institute a study on the socio-economic effects of SEZs under consideration. Table 2 summarises some of the major concerns and counter arguments.

Table 2
Arguments For and Against SEZs
(Impact of SEZ on Indian Economy)

| Issue | Argument against SEZs | Counter Arguments for SEZs |
|------------|--|--|
| Relocation | <ul style="list-style-type: none"> – Companies will simply relocate to SEZs to take advantage of the tax concessions being offered and little net activity will be generated. | <ul style="list-style-type: none"> – Special provisions have been made in the act under which tax exemptions are applicable only if the unit is not formed by splitting up, or the reconstruction, of a business already in existence and it is not formed by the transfer to a new business of machinery or plant previously used for any purpose. – Relocation of units to SEZs would involve cost and loss of efficiency. – There is little incentive to relocate due to the continuation of various export promotion schemes such as the duty drawback scheme for outside units and other business practices prevalent outside the zones. |

| | | |
|----------------------|---|---|
| Land acquisition | <ul style="list-style-type: none"> – The act will lead to a large-scale land acquisition by developers, displacement of farmers, meagre compensation and no alternative livelihood for them. | <ul style="list-style-type: none"> – The land requirement of all SEZs (including those under consideration) is 1,00,000 hectare, which is less than 0.1 per cent of total cultivable land in India. – The total land area in 212 formal approvals granted till date is 33,761 hectares out of which 50 approvals are for state industrial development corporations/state government ventures, which account for 17,800 hectares approximately. No fresh land acquisition took place for any of these cases. – Different states have their own land acquisition laws. Some states also have special land acquisition laws for SEZs. The onus is on state governments to put in place reasonable and transparent land acquisition laws for SEZs and implement them effectively. – SEZ developers are required to provide for an adequate relief and rehabilitation package for the affected. – In Maharashtra, MIDC has come out with a R&R package which includes assured employment for members of the displaced families and land at concessional rates for them in the developed area. |
| Loss of agricultural | <ul style="list-style-type: none"> – SEZ will be built on prime agricultural land with serious implication for food security. | <ul style="list-style-type: none"> – The general consensus in the board of approval and state governments is that mainly waste and barren land and, if necessary, single crop agricultural land alone should be acquired for the SEZs. If a portion of double cropped agricultural land has to be acquired to meet the minimum area requirements, the same should not exceed 10 per cent of the total land required for the SEZs. |
| Misuse of land | <ul style="list-style-type: none"> – Promoters will get land cheaply and will | <ul style="list-style-type: none"> – To regulate usage of the SEZ area |

| | | |
|-----------------|---|---|
| for real estate | make their fortune out of real estate development and speculation indiscriminately. The minimum required processing area is 35 per cent. The rest will be for residential, recreational facilities. | by the developers, the SEZ board of approvals will assess the size requirement of infrastructural facilities like housing, commercial spaces, recreational amenities, etc, based on the employment generation potential of the SEZ. In the first phase it is proposed to allow only a maximum of 25 per cent of the approved housing while the other approved infrastructure will be allowed to be created as per the developer's plans and as approved in the Master Plan. The balance housing shall be allowed to be established by the approval committee in three phases depending upon the progress in allotment/occupancy of units in the processing area. |
| Uneven growth | <ul style="list-style-type: none"> – There is a strong possibility that SEZs will be set up in states where there is already a strong tradition of manufacturing and exports. This will aggravate regional disparities. – The trend is already seen in the initial approvals. The share of the four most industrialised states (TN, Karnataka, Gujarat and Maharashtra) in total approvals is 49.5 per cent. Andhra Pradesh, Kerala and Haryana account for another 31.1 per cent of total approvals. Thus seven states account for 80.6 per cent of approvals. Their share of in-principle approvals is 63.8 per cent. On the other hand, industrially backward states of Bihar, north-east and J and K do not have a single approval. | <ul style="list-style-type: none"> – Almost every state will have SEZs under the policy. This will promote infrastructure development and industrialisation in states such as UP, Orissa, West Bengal |
| Inequities | <ul style="list-style-type: none"> – The incentives dished out to SEZs will create a tilted playing field between SEZ and non-SEZ investors. | <ul style="list-style-type: none"> – EOUs have the freedom of setting up their businesses anywhere in the country and are enjoying the benefit of DTA sales, which is not available to zone units. |

4. THE FAILURE OF SEZ

Of the 421 SEZs that have been formally approved so far, only 218 were operational in June this year. Total employment in these enclaves is 1731641 in 2017 which was 1,277,645 in 2014, as against an earlier expectation of 1,743,530 by 2009. While the share of SEZs in total exports rose from Rs. 463770 crore in 2014-15 to Rs. 467337 crore in 2015-16 to Rs. 523637 crore in 2016-17, it is believed to have declined in subsequent years. The total area under SEZs currently stands at 61,624 hectares, while Shenzhen in China alone covers 49,300 hectares.

Special Economic Zones (SEZs) are likely to be central to realising Prime Minister Narendra Modi's ambitious 'Make in India' agenda. But the withdrawal of tax incentives has made SEZs an unattractive proposition, say industry experts.

The SEZ policy continues to be relevant from a 'Make in India' perspective but several policy initiatives are necessary to get those going. Manufacturers should be allowed to sell goods in the domestic market but duty should be imposed on individual parts imported and not on the entire product, which would make it unviable. No Customs duty should be imposed on domestic value added.

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. Manufacturers in India should have the 'Most Favoured Nation' like status that implies lowest tariff under the FTAs.

Indian Council for Research on International Economic Relations (ICRIER), another Delhi-based think tank heading a study on analysing the cost benefit analysis of the SEZ policy, says the imposition of Minimum Alternative Tax (MAT) has made SEZs unattractive and adversely impacted investor sentiment. This is because MAT exemptions are punishable under WTO (World Trade

Organization) rules; there is a need to provide better business facilitation packages and incentives that comply with WTO rules.

Under the original scheme, businesses in SEZs were exempted from the minimum alternate tax (MAT) on book profits and developers were exempted from payment of the Dividend Distribution Tax (DDT). But, with indications that companies were misusing the policy for real estate arbitrage and that information technology companies were using the policy to recoup tax benefits that they lost when the Software Technology Parks of India (STPI) scheme ended, these exemptions were withdrawn.

From 2011-12, MAT exemptions for SEZ units and developers were withdrawn and DDT exemptions for developers were terminated. MAT was levied on book profits at the rate of 20 per cent, while DDT was levied at 20 per cent on dividends distributed to shareholders.

Though the issue of taxation is controversial, it is the unpredictability of the tax regime that has had an impact on investments. In their study on trade and investment barriers, Anwarul Hooda and Durgesh Rai, economists at ICRIER, argue “predictability in taxation policies is a sine qua non for making the environment conducive for investment, whether foreign or domestic, so the

withdrawal of direct tax benefits has been a setback for the SEZ programme and has affected its future prospects”.

But experts claim that taxation issues are not the only ones impeding SEZs. Despite offering over 300 incentives and schemes for promotion of manufacturing at the Centre and state levels, manufacturing growth has not risen substantially. Therefore, incentives need to be carefully evaluated and studied. Incentives should not be the only reason for units to be located in SEZs. Success depends on the business facilitation measures adopted. Location, infrastructure, logistics and professional zone management are four key factors determining success of SEZs.

A major reason for the success of SEZs in China was the creation of complementary infrastructure, power, roads and ports; these are lacking in India.

Another major reason for the SEZs languishing is the absence of external infrastructure support. The SEZs have to be connected with ports and airports with world-class roads and rail; ports and airports, too, have to be world-class, 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.

Table 3
Fact Sheet on Special Economic Zones

| | | | |
|---|---|-----------------------------------|---|
| Number of Formal approvals (As on 01.05.2017) | 421 | | |
| Number of notified SEZs (As on 01.05.2017) | 345 + (7 Central Govt. + 11 State/Pvt. SEZs) | | |
| Number of In-Principle Approvals (As on 17.04.2017) | 33 | | |
| Operational SEZs (As on 31st March, 2017) | 218 | | |
| Units approved in SEZs (As on 31st March, 2017) | 4,456 | | |
| INVESTMENT | Investment (As on February, 2006) | Incremental Investment | Total Investment (As on 31st March, 2017) |
| Central Government SEZs | Rs.2,279.20 cr. | Rs.14,521.01 cr. | Rs.16,800.21 cr. |
| State/Pvt. SEZs set up before 2006 | Rs.1,756.31 cr. | Rs.9,360.76 cr. | Rs.11,117.07 cr. |
| SEZs Notified under the Act | - | Rs.3,95,271.26 cr. | Rs.3,95,271.26 cr. |
| Total | Rs.4,035.51 cr. | Rs.4,19,153 cr. | Rs.4,23,189 cr. |

| EMPLOYMENT | Employment (As on February, 2006) | Incremental Employment | Total Employment (As on 31 st March, 2017) |
|--|-----------------------------------|--------------------------|---|
| Central Government SEZs | 1,22,236 persons | 1,15,659 persons | 2,37,895 persons |
| State/Pvt. SEZs set up before 2006 | 12,468 persons | 82,914 persons | 95,382 persons |
| SEZs Notified under the Act | 0 persons | 13,98,364 persons | 13,98,364 persons |
| Total | 1,34,704 persons | 15,96,937 persons | 17,31,641 persons |
| Exports in 2014-15 | | Rs. 4,63,770 Crore | |
| Exports in 2015-16 | | Rs. 4,67,337 Crore | |
| Exports in 2016-17 (As on 31 st March, 2017) | | Rs. 5,23,637 Crore | |

Source : www.sezindia.nic.in

5. CONCLUSION

SEZs in India have assumed to witness generation of employment, investments and exports over a period of time. However, it is considered that the SEZs model in India could not reap the expected rate of benefits pertaining to all these aspects. The underlined reasons are rise in cost of operation, global slowdown, fall in market demand, lack of skilled manpower and the primarily is imposition of MAT and DDT. Therefore, it is considered that SEZs model in India could never take off in the country.

Though, SEZs have resulted in positive outcomes in the country in terms of employment, exports and investments, yet, the concept of SEZs in India is critically argued because of several other bottlenecks. The foremost issue which overrun the positive results of SEZs in India is acquisition of farmland for establishing SEZs in the country. The other issue is related to the concentration of SEZs in the districts that are relatively more industrialized or situated in sea connected States, creates regional imbalances and income inequality and thus undermine the objective of promotion of balanced regional development in the country.

With regard to overall functioning of the SEZs, non existence of single window clearance system widely and lack of clarity in certain procedures viz. exit from the SEZs results in operational inefficiency for SEZs.

In the light of these tumbling issues, this is believed that lack of robust policy design and its efficient implementation seriously jeopardized one of India's efforts to industrialize through SEZs. The response of the developers / units within SEZs mainly points towards a need for revamping single window clearance system, efficient tax administration and review of the decision to introduce DDT and MAT.

6. SUGGESTIONS

Pertaining to different stated aspects of the study, several positive and negative facts are observed and analyzed. The major change which is observed is change in SEZs developers/units pessimistic attitude towards SEZs concept in India. Following are some suggestions that are being put forth to correct the disturbed situation in SEZ:

- Procedures are required to be more simplified, streamlined, fiscally stabilized and effective especially getting the customs clearances and sanctions of the claims.
- Timelines to be prescribed and followed strictly to reduce delays at several stages of approvals
- It is imperative to review of the single window system in various States to unplug the loopholes and it is for the State Government to take the proper initiatives on this issue.

- (d) Withdrawal of MAT/DDT exemption should be discontinued and once the policy towards benefits is made then it should not be changed till “time frame” is over.
- (e) The overall SEZ policy should be directed towards involving all the states and sectors.
- (f) Grievances redressal mechanism is required to be made stringent and effective.

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