

# Conception of Special Economic Zones in India

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## ABSTRACT

It is true that Special Economic Zones in India are afflicted with various issue but to march forward on the path of growth, India needs widespread base for industry. SEZs can play a vital role in this regard because clustering of industries can lead to better utilization of infrastructure and therefore lower infrastructure cost per unit of output and hence can promote private investments. A problem-solving approach might be helpful in addressing various issues involved with SEZs and to integrate these with overall economy and further with the entire social system. This paper is a descriptive study on special economic zones in India, begins with the projection of need to make the economic environment in India, conducive for investment and hence the need for SEZs. It further discusses the concept and history of SEZs and focuses on SEZs in India. Subsequently it touches upon some of the issues involved in the setting up of SEZs in India along with the conclusion.

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## 1. Introduction

Industry and services tend to grow faster than agriculture in the long run but the logistic and operating environment including industrial infrastructure have not been very encouraging in India. It causes lesser growth of industry and services and hence less export and employment opportunities. Quality infrastructure and friendly business environment are back bone of industry; however, absence of the said facilities poses most formidable obstacle in the way of industrial growth in India. As a result, the inflow of foreign capital is poor in India when compared to other countries. The World Investment Report, 2007 (UNCTAD) reveals that in terms of average annual inflow of foreign direct investment (FDI) for the period of 2004-2006, India with \$ 9.8 billion lagged behind China with \$ 67 billion, Hong Kong (\$ 36.8 billion), Mexico (\$ 20.4 billion), Singapore (\$19.7 billion), Brazil (\$ 17.3 billion). If we look at it from the perspective of starting a business, India's rank is 111. In India we take 1420 days for the enforcement of a contract which involves 46 procedures. This condition is also discouraging when we compare it with Kazakhstan (230 days), Russia (281 days), and China (406 days).

Thus, India needs state-of-the-art integrated infrastructure at competitive rates to create an environment conducive for industry and business. The scale of infrastructure India needs will not be created automatically, particularly in view of our relatively low spending on infrastructure (Mazumdar, 2007). Outside of SEZs, India spends just \$ 35 billion a year on infrastructure as against China's spending of \$260 billion [US ITC, 2007]. A study by the Planning Commission has estimated a funding gap of Rs. 1,60,164 crores in infrastructure investments over the Eleventh Plan (Hindustan Times, 2007). We just do not have enough resources, and therefore some interventions are necessary. A part of the gap may be met by attracting mega investments foreign as well as domestic (Mazumdar, 2007). In the backdrop of this, Special Economic Zones were introduced in India with the introduction of Special Economic Zone Policy in 2000 by the Government of India.

## 2. The Concept

The concept of special economic zones is not a new one. Robert C Haywood, Director, World Economic Processing Zones Association, reveals in his article written in 2000 that the concept of free economic zones is very old and dates back to 300 BC. The author notes that such enclaves were found in the Phoenician city of Tyre in the Greek island of Delos. The city became very wealthy with the result of such policies and was viewed as a challenge to the centralization of the Roman Empire (Ranganatham, 2007). The International Labour Organization (ILO) report traces the roots of the concept to 13<sup>th</sup> century Spain and in more recent times to Ireland and Puerto Rico which established Export Processing Zones (Chaturvedi, 2006).

The Zones are known by different names such as Free Trade Zones (FTZ), Industrial Free Zones, Export Processing Zones (EPZ), Bonded Free Zones and Special Economic Zones. Of these two basic variants are (a) the Export Processing Zone (b) the Special Economic Zones. An export processing zone is a relatively small geographical area within a country, the purpose of which is to attract export-oriented industries by offering them especially favourable investment and trade conditions as compared to the remainder of the host country (Abbott, 1997). The United Nations Industrial Development Organization identifies five basic attributes of EPZ (Chu, 1986):

1. EPZs are dominated by market orientation.
2. Epzs are restricted to a limited region.
3. EPZs specialize in the Production of export goods and offer special incentives for such production.
4. Their major aim is to attract foreign investment, to earn foreign exchange and to generate employment.
5. The secondary aims are technology transfer, development linkages and regional development.

A special economic zone has also been viewed as geographical region with different economic laws than a

country's typical economic laws with the main goal of attracting foreign investment. In economic terms a SEZ is a specifically delineated duty-free enclave and shall be deemed to be a foreign territory for the purpose of exclusive trade operations, duties and tariffs (Abhyankar, 2006). This definition of SEZ is more or less similar to that of EPZs defined above with the only difference being the promotion of exports as a major objective in the case of EPZs. Therefore, EPZs can be treated as a subset of SEZs (Ramchandran & Biswas, 2007). Certain defining features of special economic zones are:

- Special tax incentives;
- Duty free movement of goods and services;
- World class infrastructure;
- Construction intensive in nature;
- Export orientation;
- Differentiated economic management like relaxation in certain basic restrictions, applicable to rest of the country;
- Free flow of capital.

The countries which have experimented with this concept are China, United Arab Emirates (UAE), Malaysia, India, Jordan, Poland, Kazakhstan, Philippines and Russia. In 1974 there were around 80 SEZs across 30 countries, generating barely \$ 6 billion in export and employing under a million people. Three decades later in 2004, there were over 3000 SEZs in 120 countries exporting more than \$600 billion and creating several million direct jobs (Goswami, 2008). In modern times the most significant examples of success of special economic zones is in China. It had established four special economic zones in Shenzhen, Zhuhai and Shantou of Guangdong province and Xianen of Fujian province. These zones are world apart from the rest of the country in terms of economic system and philosophy. In their geographical area, these zones exceed some small countries (the geographical area of Shenzhen is 780 sq. miles). In order to minimize the possible negative impact of SEZs on rest of the economy of China, all four SEZs were set up in backward areas, but after the establishment of SEZs, these areas witnessed an astonishing growth rate. During 1981 to 1993, after establishment of SEZ's, Shenzhen grew at growth rate of 40 percent per annum, a rate that is thirty points higher than the national average of 9.6 percent (Ge, 1999).

### 3. Growth of SEZ Concept in India

The concept of special economic zone is not new for India which became independent in 1947, and chose self-sufficiency along with economic autonomy (Jaffrelot, 2006). India was one of the first countries in Asia to recognize the importance of EPZ model in promoting exports with Asia's first Export Processing Zone was set up in Kandla in 1965. The growth of SEZs in India can be explored in five stages (Grassset & Landy, 2007):

**1965-1981:** First Export Processing Zone (EPZ) was set up in 1965 in Kandla, Gujrat which happened to be a predecessor of the SEZ (Kundra, 2000). The main aim for setting up an EPZ was to promote a backward territory. However, the incentives were not strong enough to lure companies to establish their units there. More over the system of License Raj and the difficulties in imports and exports made the zone less attractive. After Indira Gandhi became the Prime Minister in 1966, the restriction increased with the setting up of

foreign investment board in 1968 and enactment of Foreign Exchange Regulation Act (FERA) in 1973. In 1973-74 Santa Cruz Electronics Export Processing Zone (SEEPZ) was set up, it could become a success when gems and jewelry units were set up in 1984 along with electronic hardware. Even the rigid bureaucracy could not hamper the success of this zone.

**1981-1990:** There was gradual opening of the economy during this period by Indira Gandhi and Rajiv Gandhi. The policy to raise the internal demand encouraged imports and growth of FDI. To balance this Government tried to raise the level of exports. In 1984 the free zone policy received a fresh start during this period multi-product zones were created in NOIDA, Cochin, Falta and Chennai. EPZ at Vishakhapatnam became functional in 1994 (Aggarwal, 2004).

**1991-1999:** In the wake of structural adjustment program, India officially opened the economy in 1991. But India tried to liberalize her economy not like a tiger but more like an elephant. In 1995 Export Oriented Units (EOU) were promoted further. In 1998 the first private SEZ started its operations in Surat.

**2000-2004:** Since 1991 the Indian economy had begun opening up but with a chain of obligations, including accepting foreign investment only with joint ventures and with export obligations. Inspired by China experience, the BJP led NDA government decided to re-launch free trade zone policy in 2000 under the name of Special Economic Zone Policy with an aim to establish integrated townships instead of simple industrial export zones.

**2005 onwards:** On 23<sup>rd</sup> June, 2005 the Parliament of India enacted the Special Economic Zones Act, 2005 to provide for the establishment, development and management of the special economic zones for the promotion of export and for matters connected therewith. Thus, inspired by China's model of SEZ the central government wanted to woo domestic and international investors towards export-oriented production. The act sought to reduce the regulatory hazards by simplifying the procedures and single window clearance for matters relating to central as well as state government. This window was supposed to reduce the transactions cost of an investor. In the absence of this single window, investors needed to knock the door of numerous state and central level ministries and officials for investment approvals.

Main objectives of the Act (Section 5, SEZ Act, 2005) are:

- Generation of additional activities;
- Promotion of export of goods and services;
- Promotion of investment from domestic and foreign resources;
- Creation of employment opportunities;
- Development of infrastructural facilities.

Any person, who intends to set up a special economic zone, may after identifying the area, make a proposal to the state government concerned for the purpose of setting up the special economic Zone or has to obtain concurrence of the state government if the proposal is made directly to the Board. A Board of Approvals has been constituted by the Central

Government to promote and ensure orderly development of the SEZs. There are three stages in approval for setting up a SEZ:

- In-Principal Approval; where the land is not in possession of the developer.
- Formal Approval; for proposals where land is in possession of the developer and other necessary procedures are complete.
- Notification; the final approval is followed by a notification of the SEZ by the Central Government, allowing the developer to start operations for development of SEZ and subsequent setting up of units.

The functioning of the SEZs is governed by a three-tier administrative set up. The Board of Approval is the apex body and is headed by the Secretary, Department of Commerce. The Approval Committee at the Zone level deals with approval of units in the SEZs and other related issues. Each zone is headed by a Development Commissioner, who is ex-officio chairperson of the Approval Committee. The performance of the SEZ units is periodically monitored by the Approval Committee and units are liable for penal action under the provision of Foreign Trade (Development and Regulation) Act, in case of violation of the conditions of the approval.

A micro-level analysis of Indian zones' contribution reveals that SEZs too have had a catalytic effect in promoting new production sectors and exporting new products. For example, the foundation of the modern gems and jewelry industry in India was set up in SEEPZ in late 1980s. The zones have also been instrumental in creating the base for growth of Indian electronics industry through technology transfer, spillovers and demonstration effect (Aggarwal, 2006).

#### 4. Issues involved in Implementation

It is evident that special economic zones have the potential to trigger off large inflow of foreign and domestic investment in development of infrastructure and productive capacities, leading to generation of additional economic activities and creation of employment opportunities. But there were apprehensions for the real potential of SEZs. It was alleged the SEZ Act, 2005 is an intriguing economic decision that has been castigated by the left, criticized by the Finance Ministry of India, cautioned against by the Reserve Bank of India and frowned on by the International Monetary Fund (IMF) (Business Line, 2006).

The exemption of SEZs from various taxes and duties reflects an undemocratic bias in favour of the corporate sector and wealthy people along with revenue loss to the public exchequer. A national level study conducted by National Institute of Public Finance and Policy (NIPFP) found that the national government will lose Rs. 97000 crore in tax revenue during 2005-10 as a consequences of tax exemption in SEZs (Parsad, 2006).

Given the tax exemption much of the investment in SEZs is likely to be at the expense of the investment in the rest of the economy. Some industrialists may shut their units in the rest of the economy to shift them to SEZs (Business Line, 2006).

Since SEZs are exempted from labour laws, the Labour Commission has no jurisdiction over factories in the SEZs. Labour Commissioner cannot even inspect the safety and environment norms in those areas without the permission of Development Commissioner. The Second Labour Commission chaired by Ravinder Verma, in its report expressed apprehensions about exemption of SEZs from labour laws. A field study conducted in three major SEZs in India (Sen and Dasgupta, 2007) confirmed a state of severe insecurity in terms of jobs contracts, income and other aspects of the status of its employees.

The state shall be divided into two distinct areas, the SEZs and Domestic Tariff Area (the whole of India but does not include the area of the SEZ), which will promote regional disparity. The experience of China suggests that the Chinese hinterland is still lagging behind the glamorous coastal regions.

However, the main issue that shook the process of setting up of SEZs in India was displacement and loss of livelihood of the people due to land acquisition. Land acquisition for SEZs has become a serious problem because earlier state governments were legally acquiring land for private SEZs without seeking consent of the local people under Land Acquisition Act, 1894. This caused protest in a number of SEZs located in India, where people refused to give up their residence and traditional sources of livelihood easily.

There was an imperative need to recognize rehabilitation and resettlement issues as intrinsic to the development process formulated with the active participation of the affected persons, rather than externally-imposed requirements. The National Rehabilitation and Resettlement Policy, 2007 calls for a broader concerted effort on the part of planners to include in the displacement, rehabilitation and resettlement process framework, not only those who directly lose land and other assets but also those who are affected by such acquisition of land. The policy necessitates the careful assessment of the economic disadvantages and social impact of displacement. The aim is to minimize large-scale displacement, as far as possible. The policy also provides that as far as possible, projects may be set up on wasteland, degraded land, or un-irrigated land. Prior to initiating the acquisition of land for a project the appropriate government should, *inter alia* take into consideration the alternatives that will:

1. Minimize the displacement of people due to the acquisition of land for the project;
2. Minimize the total area of land to be acquired for the project;
3. Minimize the acquisition of agricultural land for non-agricultural use in the project.

Another important issue involved in SEZs is environmental loss. In a time when climate change is fast becoming an everyday concern of policymakers, it is difficult to justify the clear-felling of 10 million ecologically sensitive grown trees on a coastline prone to erosion by the sea. In Mundra, Gujrat, in clear violation of the Coastal Regulation Zone Rules and various environmental laws, large tracts of land have been cleared and granted by the Gujrat government to a well-known business group to inaugurate and set up SEZ (Seminar, 2008).

To sum up, it is true that Special Economic Zones in India are afflicted with various issues but to march forward on the path of growth, India needs widespread base for industry. SEZs can play a vital role because clustering of industries can lead to better utilization of infrastructure and therefore lower

infrastructure cost per unit of output and hence can promote private investments. A problem-solving approach might be helpful in addressing various issues involved with SEZs and to integrate these with overall economy and further with the entire social system.

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