There is no doubt that SEZs boost up the exports, however, the export promotion through special economic zones have both the up and down sides.

6.1 Upside of SEZs

6.1.1 Benefits to the Indian Economy

Tangible Benefits

- Contribution to respective state’s GDP and Increase in State’s revenues from VAT, Property tax, Stamp duty etc;
- Employment generation (Direct and Indirect);
- Creation of world class self contained infrastructure;
- Improve fiscal position of the state due to consequential benefits; and
- Cascading effect on economic activity.

Intangible Benefits

- National and international recognition as Preferred Investment Destination;
- Facilitates urbanization- shift from agriculture to industry;
- Creation of high quality social infrastructure;
- Better standard of living;
- Improved competitiveness of the local industry;
• Absorption of latest technology and managerial capacities; and
• Environmental benefits from planned developments.

6.1.2 Prevention tax evasion in SEZ properties

In a bid to check the misuse of Special Economic Zones for commercial purposes like housing, building private hospitals and commercial complexes, the board of approval lay down strict guidelines for social infrastructure in such zones. Tax break will not be given to social infrastructure created in the zone beyond the stipulated levels. Permission for number of houses, hospital beds, schools and other infrastructure will hinge on the extent of job creation. The distance of an SEZ from the nearest city or town would also be considered. The board of approval will decide on what percentage of the estimated workforce would need housing, schools, hospitals and water and electric supply. The decision will be guided by the distance of the zone from the nearest city or town. An SEZ that is far from town would be sanctioned a relatively high percentage of accommodation and other amenities than a zone that is close to a town. While the workforce estimation would be based on numbers supplied by the developers, there would be some cross checking. For instance, dwellings will be built in phases. Only when the first phase dwellings have been fully occupied will a developer get permission to begin the second phase. While developers will not be prevented from building amenities beyond the stipulated level, there will be no tax sops for the extra efforts.¹

¹ The Economic Times, September 7, 2006, Page 7
6.1.3 SEZs as vehicle for job creation- reaping the demographic dividend

India needs to convert its demographic profile into a beneficial cycle of creating productive jobs for the rising work force resulting into higher savings, which in turn leads to investments and economic growth. India's median age is just under 25 years that means that there are over 500 million people below 25 years of age. Two- thirds of these 500 million people are supported by agricultural sector, a sector which contributes just 21% to the GDP. These people have rising aspirations and must find jobs in manufacturing and services sectors. If substantial job creation does not take place, it would have serious, if not disastrous, social and economic implications for the country. Hence, SEZs are job creators- it is estimated that close to 5,00,000 jobs would be created by SEZs by the end of 2007 and close to 15,00,000 by the end 2010. SEZs which have been setup/notified prior to the coming into force of the SEZ Act, 2005, at present there are 1,277 units in operation, providing direct, employment to over 2 lakh persons (about 40 per cent of whom are women). Out of this, 36,463 persons are in the private/State Government SEZs, most of which had come up after February 2006. The newly notified SEZs, which have come up after February 10, 2006, have provided direct employment to 61,015 persons.

Private investments in the 19 SEZs, which were set up prior to coming into force of the SEZ Act, 2005, is of the order of about Rs. 7,104 crore. Investment of the order of Rs. 67,347 crore has already been made in the newly notified SEZs, which came up after February 10, 2006.
Apprehensions have been expressed on misuse of the scheme and relocation of existing industries into SEZs. However, experience has shown that these apprehensions are ill founded and fresh investments and employment have been flowing into the Special Economic Zones. For example, Nokia electronics hardware SEZ in Sriperumbudur is already providing employment to 6,637 persons, majority of whom are women. Hyderabad Gems SEZ has already employed 2,000 persons after providing training to them, out of which 1,200 are girls. They have projected direct employment of about 30,000 persons. Apache SEZ, being set up in Andhra Pradesh, is expected to employ 20,000 persons to manufacture 10,00,000 pairs of shoes every month. Current employment in Apache SEZ is 4,500 persons. Brandix Apparels, a Sri Lankan FDI project, is expected to provide employment to 60,000 workers over a period of three years. Even in the services sector, 12.5 million sq meters space is expected to be created in the IT/ITES SEZs, which is estimated to translate into 12.5 lakh jobs. The benefits derived from multiplier effect of the investments and additional economic activity in the SEZs along with the employment generated is estimated to far outweigh the revenue losses on account of tax exemptions given to the SEZs. These SEZs are freshly developed industrial clusters and are not relocated from elsewhere.

6.1.4 Manufacturing needs a leg up- SEZs are the answer

Poor infrastructure, an interfering administration and unfriendly tax law environment, and unfavorable labour laws are some of the factors affecting manufacturing competitiveness in India. This is reflected in India's poor ranking
on the list of global goods exporting countries. In 2005, India's share in world goods exports was under 1 percent, which is lower than many other small economies including Thailand and Indonesia. It has become imperative in India to improving its manufacturing environment. Given the current political and economic setup, improving conditions nationwide for manufacturing will be difficult. Hence, it may be a better strategy for India to create the enabling environment in pockets- high quality infrastructure, a liberal and supportive business policy environment, which will give the necessary push to manufacturing growth. SEZs can allow the government to experiment with the liberalization of labour laws. SEZs can be particularly helpful for small and mid-sized entities, which cannot afford to setup captive infrastructure facilities like large Indian companies but can share the costs in a large group. Lastly, it can help attract foreign capital and technology.

6.1.5 Attract International Capital- Mobile Investors!

National borders have lost importance in the global competition for international investment capital. There is a global competition between countries for international investment capital more intensively in recent years. India can become a global manufacturing hub inviting mobile investors to setup manufacturing base in India for worldwide exports from the beneficial tax and other incentives available in the SEZs. If India fails to woo the mobile investments, there are other low cost countries waiting in the wings. The SEZs are ideal suited for attracting International investors, not only from big investors but also mid-sized investors. "India's SEZs will be engines of growth, supported
by quality infrastructure and complemented by an attractive fiscal package with the minimum possible regulations².

6.1.6 Infrastructure Development
Modern infrastructure is the arteries of commerce within a country. Commerce requires roads, rail lines, sea ports, airports, and reliable sources of energy at reasonable prices or else, goods can not be transported rapidly, production is interrupted, the supply chain collapses, and the economy suffers. Similarly a well functioning communications system is a pre-requisite for investment; in today’s global markets, if companies lack reliable communications, they cannot operate.

The infrastructural development within SEZ has been very widely defined, to mean all facilities needed for development, operation and maintenance of an SEZ including industrial, business and social amenities like roads, buildings, sewerage and effluent treatment facilities, solid waste management facilities, ports, airports, railways, transport system, generation and distribution of power, gas and other forms of energy, telecommunication, networks and social and recreational infrastructure like hospitals, hotels, educational institutions, residential and business complexes etc. The beauty of SEZs is that infrastructure would be created by the private sector, through private funding. With a large scale migration of population from rural to urban areas takes place, there is also a need to ensure adequate social infrastructure like houses, hospitals, schools etc.

² Kamal Nath, Industry Minister, Government of India ‘The Economic Times’ September 24, 2006, Page 9
Critics of the SEZs often ignore this aspect on the grounds that in the garb of developing, non-processing areas in SEZs developers would actually be conducting real estate business.

The government expects an additional investment of over Rs. 40,000 crore in 2007-08 and to create 10 lakh jobs in SEZs. Over 38,000 direct jobs have been created and it is expected that as many as 1.5 million jobs would be created in the SEZs already approved. The developer and co-developer of the SEZs would be entitled to the benefit of all duty exemption and remission schemes like advance authorization scheme, duty entitlement passbook scheme, and duty free import authorization scheme. The benefit derived from multiplier effect of investments and additional economic activity in the SEZs and the employment generated thus will outweigh the tax exemptions and losses on account of land acquisition. Stability in fiscal concession is essential to ensure credibility of government intentions. On the other hand, finance ministry had projected revenue losses of Rs.1.5 lakh crore including Rs.50,000 crore in direct taxes, about Rs.40,000 crore in indirect taxes and the remaining on duty waiver on raw materials for export goods.

6.2 Downside of SEZs

The SEZ act 2005 consolidates existing specialized incentive packages and in several respects, extends these to provide a range of benefits both in direct and indirect taxes for the promotions of exports as well as for the development of these zones in private/ public/ joint sectors. Other major attractions held out by
these zones are low cost finance, a system of single window clearance, self
declaration procedures, single notified agency for inspections, etc, to provide a
unique, hassle-free environment. While the new dispensation has undoubtedly
several positive features, there is a downside that has not received the attention
that it calls for.

The provisions bearing on indirect taxes are meant to compensate for any
domestic taxes that the exports from these zones (or, for that matter, from any
other areas) may suffer, and do not constitute incentives, as such. As for as it
concerns direct taxes, it is pertinent to note that while most of the incentives for
exports are either being phased out, like section 80HHC, or are being limited by
sun set clauses (section 10A and 10B), the SEZ act, 2005, is not constrained by
either of these limits. The tax benefit includes not only tax free treatment of
profits for entrepreneurs and developers in the SEZ, but also exemption form
dividend distribution tax, minimum alternate tax (MAT), and capital gain tax on
Transfer of assets in case of shift of an industrial undertaking from an urban area
to SEZ. There is no withholding tax on interest payment to non-residents and not
ordinary residents either. Even those not located in the SEZ, like investors in an
infrastructure capital fund or company which has invested in SEZ, are eligible for
tax free income from interest and dividends.

A special dispensation for exports was considered necessary when India's policy
had an anti export bias. Export processing zones were conceived as 'islands'
isolated from the restrictive environment that prevailed in the economy. The
reforms initiated since 1991 made a sea change in the environment for investors and exporters. The advocates of a regime of incentives like the proposed SEZ Act draw comparisons with the Chinese experiment of SEZs. Tax incentives and relatively less stringent labour laws are presented as the two critical elements of this success story. In terms of tax incentives, there is a vital difference between the structure of the Chinese and the Indian models. The Indian SEZ Act 2005 has made enjoyment of the tax holidays contingent on the units in the zone being net forex earners. The effect of the export-contingent subsidy implicit in the tax concession is, therefore, likely to be classified under the Two's codes as one which 'displaces or impedes the imports of a like product from another country' by 'price undercutting/ price depression' and therefore 'counter available' in the country of import. In short, incentives of these kinds can be potentially neutralized by the importing country through countervailing duties, which undermine both the gains from such an incentives regime and the revenue potential that grows with economic growth. In contrast, the Chinese SEZs enjoy preferential rates of income tax contingent on foreign investment and not on export criteria. Moreover, such tax preferences are available to foreign investors located outside the SEZs in China. Hence, in early years of China's entry in WTO, the tax subsidies granted in the Chinese SEZs have not been considered 'prohibited' or 'actionable' by other member countries of WTO during the period 1995-2004. 28 out of total of 108 actions were initiated against India's exports. Even in the case of China, although the tax subsidy to SEZs is not contingent on exports, the fact that the SEZ model has given a differential advantage to China's
exports, has led to a certain degree of rethinking by the Chinese. In terms of labour laws, the difference is more in perceptions than in fact. As captured in the report of the second national labour commission of India, China has detailed regulations governing employment plans on foreign invested enterprises, covering recruitment, signing of labour contracts, condition for retrenchment, responsibility to provide basic living allowance to the retrenched and so on. The critical difference could be in the enforcement of labour standards in China, the 'gains' from which might be difficult to enshrine in enactment in any other locale. If the rate of growth of new approvals with in five months of passing of new SEZ Act remains continue in future, there is likely to be a deluge of applications, leading probably, to virtual de- industrialization of non-SEZ regions, with consequent repercussion to tax revenues. A proposition being advanced perspectives as a counter to the revenue loss argument is that employment generation/transfer of technology/ FDI inflow to result from the setting up of SEZ, tax heavens would set in motion such as virtuous cycle of higher investment-higher income- higher expenditure- higher savings and the economy would be lifted to such heights that revenue loss resulting from tax exemptions under the SEZ regime would be offset by revenues and savings in the chain effect of higher levels of economic activity. However, the flaw in this thesis is that it ignores the legitimacy of the government's need for revenue. After all, the right environment for evenly spread growth requires much more extensive and efficient infrastructure and social security, without which it will never be possible to relax
our labour laws or give sufficient impetus to overall growth.3

6.2.1 Real estate scams through SEZs

The government has recently notified the rules for a new SEZ scheme. While these are presently mired in controversy, a group of ministers has been setup and would, doubtless, soon resolve the issues. What is surprising is that disagreement apparently centres on the minimum size of a SEZ. Intended, presumably, to boost exports, employment and investment, there is no mention of any minimum requirement of these. *4 In a country over a billion people, one would assume that all schemes would keep in mind the need of optimize land utilization, instead, the SEZ scheme seems to encourage maximization of land acquisition. To compound this, state governments are reportedly offering land to SEZ developers at concessional rates. Sharp developers are unlikely to pass up this opportunity to embark on and grab mission, knowing that the one resource that is scare and inelastic is land. Be prepared, then, for many thousand of displaced farmers as state government and private developers go on a land acquisition overdrive, irrespective of its impact on the economy, the black money will certainly get a big boost, since land deals and compensation payments are known to hot- beds of corruption. This is an important issue, but there is more vital and basic one that under prints the very approach. The SEZ scheme, as

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3 Bulbul Sen, NIPFP, New Delhi, The Economic Times Feb 21, 2006, Page 11
conceived, favors a centralized paradigm of development. This is based on the Chinese SEZs, particularly, massive SEZs like Shenzen⁴.

The argument is that such agglomerations have a show-balling effect, with a positive feed back loop between infrastructure creation and attracting more units or investments. It is ironic that when China is worried about the economic disparities created by this model, and is focusing strongly on broad basing development in its next five-year plan; we in India are seeking to emulate these nodes of development approach.

We need to recognize that the trickle-down approach is not working. Over 160 'naxal -affected' districts bear testimony to this fact, as do widespread suicides by farmers. That this is happening despite 7 to 8% growth is a clear signal that the present model is socially unsustainable. Development needs to be more wide spread, but the SEZ scheme will, by acting as a magnet for new projects, creating a greater degree of concentration of investment, employment and prosperity. There has so far been little debate about this aspect. The discourse is increasingly uni-dimensional, focusing narrowly on economics, growth rates, investment incentives and efficiencies. There is need to discuss the broader public policy aspects, especially those relating to equity, regional balance and decentralization. Most of big announcements are mere relocation within the country, primarily to minimize taxes. Rather than Income tax exemptions, a SEZ

⁴ Kiran kartik, president NASSCOM, The Economic Times, May 9, 2006, Page 9
really needs uninterrupted power supply, efficient logistics, freedom from bureaucratic red-tape, raw material at world prices, flexible labour laws, high quality space at reasonable cost, and broad band communication.

Lest this list seem like an impossible dream, examine the Software Technology Park (STP) setup to serve the IT software and BPO sectors. The STPs have all the above ingredients, though the flexibility on labour laws is rather limited. Unlike the first generation SEZs, which are dismal failures, the STPs have been outstandingly successful; with software being India's top export (US$ 24 billion last year). The most vital element in the STP scheme is that the STP is not constrained to a geographically defined area. Instead, a unit can be setup at any location; registration with STP is all that is required to avail the benefits (given to all exporters, and not just to the IT sector, as is some times alleged). This has enabled the IT industry to grow in multiple locations, not just the top six metros, but also many other medium places. In at last half a dozen states, the IT industry is growing in towns that are even smaller, creating employment and spurring the local economy. The fact is that the genius of India lies in grass- root entrepreneurship. It has been argued in a research report is India's advantage vis-a Vis China. Socially, culturally and politically, we are not geared to executing and operating, efficiently, large centralizes projects. There is some notable exception, but one has only to look at any large project to see the truth of this. Such projects are China's strength, not ours.
So if we are to play to our strengths, a few conclusions follow;

(i) We need to maximize employment and exports, not land acquisition;

(ii) A multiplicity of dispersed SEZs are needed, spreading employment and economic growth across the country;

(iii) For services, in particular, a virtual concept (modeled on the STP scheme), with no minimum area requirements, will work better;

(iv) The focus needs to be on assured inputs/ infrastructure (power, raw materials, logistics, regulations) of world class;

There will, of course, be the usual arguments about the scope for cheating, difficulty in monitoring a large number of small/ virtual SEZs etc. However, we have a real life example of the STPs where infringements are, at worst, marginal. Today, technology makes it simple to monitor dispersed and numerous activities and to quickly detect any deviations. In any case the fear of leakages and revenue loss must be balanced against the gains of dispersed development.

The SEZ scheme raises some basic policy issues:

Concentrated vs. dispersed development;

Centralization vs. decentralization;

Moving people to work-sites vs. taking work to where people are;

Optimizing the rare resource (land) vs. its profligate use.
It is necessary that we quickly make decisions about the SEZ rules; more important, though, is that we also debate more thoroughly the basic model of development\textsuperscript{5}.

6.2.2 SEZs give rise to new-age landlords

Size of land sanctioned to new SEZs suggests so. If this trend continues, SEZs would soon be the country's biggest land holding entities. With the SEZs becoming the flavour of season and as its numbers keep rising by the day, dissenting voices are gaining momentum in government quarters about the land being approved for these projects. A section of the government has also started expressing suspicion about the whole SEZ concept and its utility. "There is very reason to suspect the real motive of some of the SEZ promoters. Their prime interest appears to be real estate. There are enough examples around the industrialists making more money by selling their real estate interests, which they acquire at throw away price, than running the industry." Some of the SEZ proposals near Mumbai are really gigantic.

The following list of companies that have been eyeing huge government land at a concessional rate will substantiate the argument:

<table>
<thead>
<tr>
<th>Developer</th>
<th>Location</th>
<th>Area (Acres)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marathian Realty</td>
<td>Panvel</td>
<td>2,750</td>
</tr>
<tr>
<td>Dewan Investment</td>
<td>Thane</td>
<td>2,500</td>
</tr>
<tr>
<td>Pan India Paryatan</td>
<td>-</td>
<td>2,500</td>
</tr>
<tr>
<td>Navi Mumbai SEZ</td>
<td>-</td>
<td>3,125</td>
</tr>
<tr>
<td>Maha Mumbai SEZ</td>
<td>-</td>
<td>25,000</td>
</tr>
</tbody>
</table>

\textsuperscript{5} The Economic Times, May 10, 2006 Page 9
6.2.3 Who will manage the lives in SEZs?

Large special economic zone developers in the country may have a problem in hand. With huge number of people expect to live in the proposed SEZs, developers are required to have municipalities to govern them. While the constitution makes it mandatory to have a municipality, the law is unclear on who has the onus of setting up these bodies in the proposed SEZs. The chief developer of DLF's SEZ said that we are planning to setup a 20,000 acres SEZ in Haryana while SEZ act specifies a development commissioner that will be appointed by the government for each SEZ it is silent on the mandatory setting up of a municipality in the area. Though the 74th constitutional amendment makes it mandatory for state governments to setup municipalities depending on the size of the area, SEZs come under the purview of central government. The issue gets more complex as different states have different laws governing industrial units.

Killing the best, aiding the worst SEZs

The government worried about criticism that SEZs could be real estate land grabs. It became more worried after violent farmer agitations against land acquisition at Singur and Nandigram. Across India, opposition parties began organising farmers to resist acquisition for large projects. This has driven the

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6 Economic Times, May 31, 2006, Page 7
change in SEZ policy. The new rules say that SEZs can not exceed 5,000 hectares in size. State governments can set even lower ceilings. This means that no SEZ in India can be more than a quarter the size of Shenzhen. SEZ developers who earmark huge tracts of land for airports and ports will lose out to developers who do not. Far from encouraging the creation of world-class infrastructure, the new policy penalizes it. Land acquisition should ideally be settled through community decisions. If a developer wants a parcel of land, affected farmers should vote on his proposal. Decisions made by farmer communities rather than State governments will promote both justice and peace.

The new rules lay down that all land must be acquired directly by corporations. Voluntarism in sales is an excellent principle. But if land purchase is voluntary, why place any ceiling on size? State governments have jurisdiction over land and farmer agitations, and so are entitled to place ceiling. But central government ceilings defy both economic sense and State’s rights. Today every State government acquires land for industrial purposes, and sells or leases this to private industries. These include giant projects like the POSCO mines and steel plant in Orissa, covering thousands of acres. The principle of voluntary sale needs to apply to all acquisitions, not just SEZs. Actually, the new rules will encourage the worst sort of SEZs. They will encourage tiny SEZs near cities. These will raise no political problems in land acquisition. They will provide real estate bonanza for developers and kickback for politicians. They will strain existing infrastructure instead of improving it. And for this they will get unwarranted tax breaks. The rules aim to kill the best SEZs, the giant ones with
world class infrastructure that can compete with Shenzhen. They greatly penalize developers who provide captive airports, ports and power plants.

We desperately need a better SEZ policy, which requires:

- Tax breaks should be given only for giant SEZs providing world-class infrastructure;
- No ceiling should be placed by central government on voluntary land purchases;
- Community decision-making in land acquisition should be encouraged or made mandatory;
- State governments should acquire the land of naysayers when 75% or more of landowners have approved sale to a developer.
- Small SEZs should be obliged to pay a heavy fee upfront, which should be used to finance fresh infrastructure to meet their needs; and
- The 5,000 hectare ceiling should be waved for land devoted to airports, ports and power stations.

6.2.4 SEZs: Bad vs. Ugly

*Tax Gain or Tax Loss*

Finance Minister Worries that excessive tax breaks for and SEZs will cost Rs.70,000 crore of foregone revenue. Exports units in SEZs will get a 100% tax holiday for five years, 50% tax break for five years, and a further tax break for five years on production based on reinvestment of profits. SEZ developers will

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7 Swaminathan S Anklisaria Aiyar, The Economic Times, April 11, 2007, Page14
enjoy a tax holiday for 10 years. But Commerce Minister backed by many chief ministers, argues that Finance Minister's projections of tax foregone are highly exaggerated, since exporting units already enjoy many tax breaks. He argues further that SEZs will create a huge tax base and will provide a net tax gain of Rs.40,000 crore. Which estimates are right?

Giant SEZs or Mini SEZs

A good model is Shenzhen, China’s premier SEZ, which covers almost 20,000 hectares, exports more than the whole of India, and attracts more FDI than the whole of India. Giant SEZs are in effect composite cities with their own ports, power stations, water supply and Airports. However, India’s SEZs law does not emphasize either size or infrastructure. Sector-specific SEZs need be no more than 100 hectares in size, and no more than 50 hectares in special category states. SEZs for information technology, biotechnology and jewellery can as small as 10 hectares, smaller even than some schools. Clearly these mini SEZs are not going to be enclaves of world-class infrastructure. They are simply going to be tax havens. The tax holiday for software and BPO exporters is coming to an end in 2009. Moving into mini SEZs will enable them to extend their tax holiday for another decade. Far from becoming world-class enclaves of infrastructure, the mini SEZs will burdens on existing infrastructure. Small SEZs in or near existing cities will add to road congestion, power and water shortages.
6.2.5 Government stands to lose Rs90,000 crore on SEZs

The new SEZ Act may well turnout to be a revenue black hole for the government, given a scale of fiscal exemptions and the scope of entitlement. Initial estimates by the finance ministry indicate that the government would stand to forego almost Rs.70,000 crore on direct taxes alone by 2009-10 given the spate of SEZ applications that have poured in. and that is not all, the total loss on indirect taxes is estimated at another Rs.20,000 crore.

The new SEZ Act, which has brought in several amendments from the initial draft, spans both manufacturing and services. Professionals (except lawyers and accountants), construction, distribution (whole sale), education, entertainment and financial service providers are among the host of services that could enjoy tax holidays. This would mean that tax waivers under the SEZ Act would allow even service providers such as cable network providers or real estate builders in SEZ to enjoy the same fiscal benefits as manufacturing plants located in these zones and exporting goods to foreign markets. This would not only impact the FRBM targets but also hits the government’s expenditure programme.

It has been estimated that the new SEZ Act would attract investment of the order of Rs.1,00,000 crore over the next three years, with an employment potential to over five lakh apart from indirect employment during the construction period of SEZs. The amended SEZ Act also has allowed transferred industrial units to be treated on a par with green field investments. This would lead to large scale deindustrialization and transfer of units from DTAs to SEZs. This would bring
about an imbalance both in terms of industrial development in the country and the labour movement. Given the lack of clarity between a 10 hectare plot to 1,000 hectare. "It is difficult to build world class infrastructure without a standard scale."  

Finance ministry's estimates recently, the government may end up losing indirect and direct tax revenue of Rs.93,900 crore over the next four years on account of existing and new export oriented units shifting to SEZs. So, the ministry which is trying its best to reduce the government's fiscal deficit, is not at all happy with the potential loses that would accrue for more SEZs coming up. The size and number of SEZs is another major drawback that some experts are worried about. Although SEZs appear to be the right fix for the country's manufacturing exports, the government's current approach may not be the best way to boost Indian manufacturing particularly in the small and medium entrepreneur sector. The new law is attracting SEZ applications from investors primarily seeking to capture the tax benefit. Most applications for new SEZs are to small to attract the major push needed for small and medium scale manufacturing. However, the centre should push for five-six large SEZs of about 40 to 50 squire miles, in coordination with the State governments. The government should take the lead in conceptualizing these SEZs, arrange private sector participation and if needed provide capital subsidy. Globally, SEZs have been successful because of their large size and fewer numbers.  

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8 The Economic Times, April, 10, 2006, Page 9
9 The Economic Times, August 31, 2006, Page 7
6.2.6 **SEZs may create imbalance: RBI**- RBI has voiced concern that the growth of SEZs across the country could aggravate uneven development by pulling out resources from less developed areas. Moreover, the central bank has said that revenue loss suffered by States on account of tax breaks can be justified "only if the units in the SEZ established backward and forward linkages with the domestic economy. The simplification of procedures and tax breaks as envisaged by the SEZ Act are expected to attract investments of about Rs.1,00,000 crore and help create 5,00,000 jobs. Developers are allowed to set up sector-specific and multi-product SEZs. However, the tax breaks have worried the finance minister as he expressed concern that there would be a revenue loss estimated at over Rs.1,00,000 crore. The government plans to go ahead with SEZs, without fixing any cap on the number of zones that can be set up in the country. The expectation is that the new economic activity would more than make up for the loss on account of foregone tax revenue. The planning commission has come out to support of RBI by saying that it is not in favour of concessional finance for SEZ projects but to treat lending to SEZs at par with real estate.

**SEZs as a Chinese puzzle**- The obvious lesson for India is that we can not simply invest in SEZs and expect the benefits to automatically trickle down to the rest of the economy. There would have to be an effort to simultaneously remove bottlenecks that prevent the less developed parts of the economy from tapping the benefits of globalization. Some of these bottlenecks would be within the country, investments in specific elements of sericulture infrastructure, for

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instance, would help Indian raw silk compete with Chinese imports. But the real challenge would be in recognizing that different parts of the country could have very different requirements from globalization. It is difficult to see Indian policy makers going as far as the Chinese have in this direction. The Chinese have been willing to accept international alliances that would involve only a part of their country. It does not seem extremely unlikely that India will accept, say, the north-east being a part of a separate alliance with Myanmar or other countries in that region. Despite the flaunting of the Chinese example in the SEZ debate, the Indian mindset is clearly not in position to learn all the lessons on globalization that China has to offer. But there is at least one lesson it can no longer afford to ignore. Globalization is not just about the glamorous economic activities that can be generated simply by reducing trade barriers. It is also about investing to help the less successful sectors benefit from a global market.

6.2.7 RBI wary of Offshore Banking Units (OBUs) in SEZ

The policy of Special Economic Zones is facing fresh resistance from the RBI, this time on the issue of allowing Offshore Banking units. The National manufacturing Competitiveness Council (NMCC) set up by government has also joined the issue with the government saying the policy is biased against small enterprises. The RBI has also written to finance ministry saying it has serious reservations on permitting scores of OBUs coming up in proposed SEZs across the country. If the number of OBUs were to match the number of SEZs proposed, it would tantamount to a full capital account convertibility regime. RBI is like to be

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cautious about granting approvals to OBUs, and may be open to allowing OBUs only in genuine multi-product SEZs. The other concerns relating to OBUs is that the government's overseas borrowing policy provides the unrestricted foreign borrowings by units located in SEZs with an overall cap. If business entities in such units access foreign debt, the country's external debt would shoot up substantially, it has been pointed out. The current norms on external commercial borrowings stipulate a ceiling of $500 million for such units in SEZs. The apex bank has also expressed concern over some legal provisions contained in SEZ Act, which give the government power to override other existing legal provisions on setting up of banking units. The act also grants the government powers to approve the setting up an international financial services centre in the zones. It is not clear how the central bank will deal with such overriding powers emanating from the Act. RBI had also made clear its reservations about the manner in which SEZ proposals were proliferating. At last count, the government had approved over 150 proposals for setting up such zones. The central bank feels this could trigger uneven development by pulling out resources from less developed areas. Besides, it reckons that the revenue loss suffered by the government can be justified only if units in SEZs establish forward and backward linkages with the domestic economy.\textsuperscript{12}

While announcing the Offshore Banking Units Scheme on November 12, 2002, the RBI had stated that these units would be virtually foreign branches of the Indian banks. These would be exempt from CRR, SLR and given access to SEZ

\textsuperscript{12} The Economic Times, September 7, 2006, page 1
units and SEZ developers to international finance at international rates. OBUs deal in foreign exchange, source their foreign currency funds externally, follow all prudential norms applicable to foreign branches and are entitled for Income tax exemption under section 80LA.

Concerns have been raised that, if every SEZ unit is permitted to borrow $500 million annually, funding by OBUs to SEZs would lead to increase in external debt of India. However, ground realities are entirely different. Since the OBU scheme started four years ago, only seven OBU branches are functioning in SEZs which includes five in SEEPZ SEZ Mumbai (PNB, SBI, UBI, BOB and ICICI), one each in NOIDA SEZ (Canara Bank) and Cochin SEZ (SBI). No OBU has been set up in Kandla, Falta, Chennai, Visakhapatnam, Surat or Maharashtra SEZs. Total lending by OBUs to SEZ units, in four years, is approximately between $150-200 million. The operations of OBUs are not viable at present because of a number of restrictions imposed on these OBUs by RBI. This is evident from the fact that PNB even after operating an OBU in SEEPZ SEZ for three years permitted its license to set up OBU in NOIDA SEZ to lapse. Hence, it is imperative that the creation of healthy and thriving OBUs of global size for effective functioning of SEZs.

There is a lot of attention recently on setting up SEZs and OBUs. This does not make sense. Firstly, these units can do business only in the respective SEZs in which they are located. Such banking units will have some relevance until full

\[13\] L.B. Singhal, DG, EPC for EOUs and SEZs, The Economic Times, September 12, 2006
capital account convertibility happens or till the time further liberalization takes place. It is to be noted that in the near future uniform regulation in the form of fuller capital account convertibility, in case the Tarapore Committee report is accepted, will render OBUs completely irrelevant. OBUs as vehicle for extending dollar loans at international rates have no use as long as they are restricted to doing business only in the zones in which they are located. They create an unnecessary regulatory arbitrage. Having several OBUs is not necessary. What will happen is that they will unnecessarily encourage practices such as booking business because there is some arbitrage advantage on offer. In such a scenario, they will most certainly find some loopholes in the regulatory environment, which will then get exploited. In turn, the interest of borrowers might get severely eroded. Additionally, the emphasis then may not be on increasing business and augmenting value. Unlike in other developing countries, OBUs in India have a limited mandate.

The overriding objective has always been to facilitate the growth of SEZs rather than facilitate the setting up of OBUs on a large scale. This is line with the cautious policy adopted by the RBI as far as opening up the financial sector is concerned. OBUs are losing relevance with increasing globalization. In fact, these will be no use after the economy opens up fully. At a time, when such a trend is visible elsewhere, we seem to be going against the trend. Only one or two OBUs will suffice instead of having several of them spread across the country\textsuperscript{14}.

\textsuperscript{14} K. C. Chakrabarty, CMD, Indian Bank, The Economic Times, September 12, 2006, Page 12
6.2.8 No honest implementation of SEZ Act 2005 and SEZ Rules 2006 by government officials

The government has issued an instruction to all customs and excise commissioners, emphasizing that all activities relating to SEZs shall be guided by the provisions contained in the SEZ Act of 2005 and the SEZ rules of 2006. The department of revenue has working on a new comprehensive circular incorporating the provisions in the SEZ Act. Meanwhile, the instructions issued by the commerce department will hold good for the field formations. On the other hand SEZ units complained that excise officials were not willing to allow them duty free procurement of goods from the domestic tariff area. The official instruction stated that specific representations have been received regarding non-implementation of rule 30 of the SEZ rules of 2006, which provide the procedure for procurement of goods by the SEZ units from the DTA without payment of central excise. The instruction point out that since the SEZ Act has been enacted by the parliament, all activities related to SEZs shall be guided by the provisions contained in the SEZ Act, the provisions of the SEZ Act and rules will have overriding effect over the provisions contained in any other act. The note further said that the provisions of sections 20, 21 and 22 of the SEZ Act relating to single agency, single enforcement officer and inspection, search and seizure have yet been operationalised. Hence, so long as these sections are not operationalised, different agencies and officers, as empowered under the
relevant acts before enactment of the SEZ Act, will continue to operate till such
time these provisions of the SEZ Act take effect.15

6.2.9 Can the SEZ Policy undermine agriculture?

India's growing plans have intensified in recent time. Some argues that
agriculture must be the priority, while others contended that now is the moment
for industry. Be it SEZs or increasing urbanization, there is no debating that
change has arrived to India's doorstep and that agriculture will need to adopt.
India now needs to welcome this change and manage it successfully. But those
who oppose SEZs seem to have forgotten this reality. The fear that India's food
self-sufficiency could be weakened as some agricultural land is taken out of
production needs to be grounded in hard facts, not emotion. A look at China's
experience demonstrates how agriculture and industry can co-exist, and even
flourish. Today, China produces almost twice as much food as India, and with les
arable land! And its industrial sector is also outperforming India's. 'The Dragon
and the Elephant' project found that China's market-oriented reforms in
agriculture during 1978-1984 catalysed productivity, raising agricultural GDP by
7% per annum and agricultural incomes by almost 14% per annum. Even
between 1990-97, agricultural productivity in China grew up by nearly 4% per
year. Not surprisingly, improved productivity enabled people to move off the farm
and into new income generating activities, such as small scale food processing
and technology-driven industries. On the contrary, in Indian agriculture public
investments are in decline, infrastructure is weak, and marketing institutions are.

15 The Economic Times, August 11, 2006, page 6
still not fully liberalized. As a result, agriculture is performing below its potential. A large infusion of capital in Indian agriculture is needed to improve infrastructure and post-harvest facilities, especially for high value products such as vegetables, fruits, eggs and meat. Unlike wheat and rice, these products do not require large amount of land for cultivation. An overseeing, multi-stakeholder body could be established to ensure that SEZ development in India is balanced, transparent and reflects all interests. It's time for India to open the door to change\textsuperscript{16}. India's land area is more than 297 million hectares and its arable area is 162 million hectares, area under cultivation is 120 million hectares. So even at present a good 40 million hectares are left uncultivated. This does not include semi-arid uncultivated lands, which can also be brought under cultivation of high value crops as demonstrated by Israel. Compared to these, the 150 or so SEZs formally approved so far will cover a bare, minimal 30,000 hectares. In statistical terms this will not be even considered in errors and omissions! A large portion of the land to be allotted to the approved SEZs will come from the land already acquired by the respective State Industrial Development corporations. Some large units being promoted by specific corporate houses have caught public attention, but that should not be used to pose an irreconcilable trade off between agriculture and SEZs. Therefore, it is time to have a good look at the state of policy and institutional regimes in agriculture than to be distracted by non-issues like SEZs. It is not becoming any government for its various constituents to be publicly squabbling specially matters of high policy. The minimum that can be

\textsuperscript{16} Ashok Gulati, Director in Asia, International Food Policy Research Institute, The Economic Times, October 3, 2006, Page 11
expected, and there are built-in institutional mechanisms for achieving it, is that inter-ministerial differences will be sorted out before any policy is announced. Secondly India should follow the Chinese example of trying out schemes as pilots, seeing the results and then expending it or wrapping it up on the basis of actual results. The great urge to discuss all possible contingent outcomes ex ante may in keeping with our self image of being the world famed argumentative Indians, but it does not good at all to economic progress17.

**States told to help farmers harvest best price for land**

The central government wants states to specify that floor rate for buying land from farmers is the minimum rate and not the ceiling. State governments have to encourage transaction of land at prices closer to market rates and not closer to floor price. The Rural Development Ministry has sent a note to states specifying the need to enhance floor rates that have been kept low for long. For this purpose the ministry is preparing a rehabilitation and resettlement policy. In addition, there are plans to reduce the disparity between prices of industrial land in various states. For instance, floor rate in western region is just Rs. 5 lakh per acre against Rs.20 lakh in Haryana, Rs.3 lakh in west Bengal and Orissa.

- the total land requirement for the 234 formal approvals granted till date is approximately 33,808 hectares, of which about 60 approvals are for state industrial development corporations/ state government ventures (over

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17 Rajiv Kumar, Director ICRIER, The Economic Times, October 3, 2006, Page11
17,800 hectares). The land for 63 notified SEZs where operations have commenced is 8,051.56 hectares only;

- of the total land area of 29,73,190 sq km in India, total agricultural land is 15,34,166 sq km (51.6%). The land in possession of 63 SEZs notified amount to approximately 67 sq km only. The 234 formal approvals granted also works out to only around 350 sq km;

- expected investment and employment from SEZs (by December 2009):

  By the 63 notified SEZs:

  investment - Rs.53,561 crore
  employment – 15,75,452 additional jobs

  If 234 formal approvals become operational:

  investment – Rs. 3,00,000 crore
  employment – 40 lakh additional jobs.

(Source- Dept. of Commerce, The Economic Times March 30, 2007)

**SEZs are like the curate’s egg:**

SEZs have been criticized on the grounds of attracting investment only by offering distortionary incentives rather than building under lying competitive conditions. These incentives create a fiscal burden on the tax payer and hurt environmental and labour standards. The direct and indirect costs of SEZs do not benefit the rest of the economy and, instead, lead to enclaves of prosperity.

However, the broad consensus seems to be that well-implemented and designed SEZs can bring about many desired benefits for the host country, increases in employment, increased foreign direct investment, general economic growth, foreign exchange earnings, international exposure, and transfer of new
technologies and skills. On the other hand a 'piecemeal approach' of the kind envisaged by SEZs makes sense only in environments where it is necessary circumvent unfriendly business environments. In these circumstances SEZs can be viewed as a means to spurring reforms nationwide. The caveat is that all this is only possible and successful when the SEZs are developed effectively. A poor designed SEZ can have many negative consequences for a host country, labour and environmental abuses, tax evasion, a stunted liberalization policy etc. The key elements for success of SEZs are political will, location, domestic and international linkages, human capital and coordination with a comprehensive country-wide reform surprisingly, the rational for SEZs seems to actually increase rather than decrease in the context of trade reforms, going by the increase in the number of such zones. It is hard to quantify either the positives: technology transfer, sustainable development and spillover effects or the negatives: environmental degradation, use of scarce energy resources, social problems, cost of administration and management. The issue of labour and acquisition of farmers land remain major areas of concern with such zones often viewed as a deliberate counter to workers and farmer's attempts to organize their collective interests with concerns of capital dominating over human concerns. Nonetheless outcomes could be improved if SEZs are converted into normal economic zones once they have matured to levels of performance and scale. Similarly charges of level playing field can be avoided if areas that are depressed or under developed, yet have committed local leadership are selected for zone sites.  