Study On Challenges And Future Of Special Economic Zone

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Abstract:

This paper reveals that the biggest challenges faced by SEZ's in today's scenario are the taking away of agricultural land from the farmers. The farmers are being paid disproportionate money which is not in lieu of the current land prices. Moreover SEZ's are leading to decrease in crop production (arable Land Grabbing!) thus slowing down of agricultural activity in the country. (Though it may help boost it in other ways by increased export of local goods, both processed and non-processed). More and more farmers are moving towards the lucrative manufacturing side in search of greater economic security. Moreover the greatest problem that seems to be emerging out is that arable land is being used for non agricultural purpose which could lead to food crisis and loss of self sustenance in future.

Introduction

An SEZ is a trade capacity development tool, with the goal to promote rapid economic growth by using tax and business incentives to attract foreign investment and technology. Today, there are approximately 3,000 SEZs operating in 120 countries, which account for over US$ 600 billion in exports and about 50 million jobs. By offering privileged terms, SEZs attract investment and foreign exchange, spur employment and boost the development of improved technologies and infrastructure.

Moreover SEZ's provide a medium wherein it not only attracts foreign companies looking for cheaper and efficient location to setup their offshore business, but it also allows the local industries to improve their export through a proper channel and with the help of the new foreign partners to the outside world at a very competitive price. SEZ's offer relaxed tax and tariff policies which is different from the other economic areas in the country. Duty free import of raw materials for production is one example. Moreover the Free trade zones attract big players who want to setup business without any license hassles and the long process involved in it. Most of the allotment is done through a single window system and which is highly transparent system. The bottom-line therefore is increased export and FDI (Foreign Direct Investments) enabling increased Public-private partnership and ultimately resulting in a development of world class infrastructure, boost economic growth, exports and employment.

The concept of SEZ's was largely pioneered by China, wherein the SEZ's contribute to 20 percent of the total FDI. Then the SEZ model was also successfully implemented in Poland and Philippines. In the former the SEZ's contribute to almost 35 percent of the FDI inflows. Shenzhen in China has been at the helm of rapid economic development, after growing by a staggering 28 percent for the last 25 years.

The SEZ's are important in today's context for the third world countries which have been in the race for rapid economic growth. There are many positives which emerge out of establishing an SEZ. Let us have a look on these factors.

For undertaking any kind of massive development program the government requires huge amount of funds. So it looks out for potential partners to help the government carry out the program. Now say for setting up an SEZ, the government may tie up with a private partner whose willing to invest in that area, thus a win-win situation for both. As in the government gets the capital needed to establish the required infrastructure and also the expertise. The private player on the other hand gets the right to market and use the SEZ's with relaxed tax laws, thereby increasing its revenue generating capacity and also carrying out the economic growth of the company in a more efficient way with the better tax policies. Actually SEZ's with relaxed import tariffs help the Import dependent and export driven industries to flourish by helping them develop manufactured goods at competitive prices.

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

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Moreover SEZ's improve the country's foreign export. Because of the increased FDI and Private Equity presence, the local manufacturers get to tie up with these big names and export their products which now carry a better brand value, therefore helping in creating a greater demand for the goods of local manufacturers. Moreover the massive capital required for expansion is brought in form of FDI resulting in increased economic activity.

The increased exports from the country bring in more revenue for the country which improves the economic growth.

SEZ's help in creating a balanced economic growth in a country if they are properly located and implemented leading to tapping of local talent and contributing to increased economic activity in the area.

Drawbacks:

SEZ's in China were initially exempted from national Labor Laws (despite being a communist country!). This model sustained initially because the foreign investors were given the leverage to train the workers and even fire them if incompetent. This Hire or Fire policy initially helped in sustaining foreign investors' confidence in the Chinese domestic labor competence, but in the long run such laws must be made more stringent once the confidence is reposed so as to hedge the workers from hostile company' policies.

The SEZ's if not properly located could lead to Supply Chain Management problems as well. Moreover improper planning could lead to unbalanced growth in the region giving an impression of pseudo-development. For example most of the SEZ's in China are in proximity to the ports and also close to each other, while these have been at the helm of economic development most of the interior hinterland is vastly underdeveloped. SEZ's could also lead to income disparities with divide between the rich and poor increasing if not properly planned.

SEZ's mostly if setup for the manufacturing sector should be carefully planned to carry out proper pollution monitoring and control mechanism. Stringent measures may prove to be expensive but are also extremely important. Shenzhen in china has been the worst affected among SEZ's in China where the sky is grey for most part of the day courtesy the polluting industries. The measures should be taken to make surroundings livable for multitude of people living in the SEZ's. Moreover care should be taken to properly treat effluents from industries not to affect surrounding rivers. Also the SEZ's should be carefully planned

not to affect the natural habitat around (Gurgaon SEZ affecting the Bharatpur bird sanctuary)

India and SEZ:

The SEZ policy was first introduced in India in April 2000, as a part of the Export-Import ("EXIM") policy of India. Considering the need to enhance foreign investment and promote exports from the country and realizing the need that level playing field must be made available to the domestic enterprises and manufacturers to be competitive globally, the Government of India in April 2000 announced the introduction of Special Economic Zones policy in the country deemed to be foreign territory for the purposes of trade operations, duties and tariffs. To provide an internationally competitive and hassle free environment for exports, units were allowed be set up in SEZ for manufacture of goods and rendering of services. All the import/export operations of the SEZ units are on self-certification basis. The units in the Zone are required to be a net foreign exchange earner but they would not be subjected to any pre-determined value addition or minimum export performance requirements. Sales in the Domestic Tariff Area by SEZ units are subject to payment of full Custom Duty and as per import policy in force. Further Offshore banking units are being allowed to be set up in the SEZs.

India is one of the first countries in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports. Asia's first EPZ was set up in Kandla in 1965. With a view to create an environment for achieving rapid growth in exports, a Special Economic Zone policy was announced in the Export and Import (EXIM) Policy 2000. Under this policy, one of the main features is that the designated duty free enclave to be treated as foreign territory only for trade operations and duties and tariffs. No license required for import. The manufacturing, trading or service activities are allowed. While EPZs are industrial estates, SEZs are virtually industrial townships that provide supportive infrastructure such as housing, roads, ports and telecommunication. The scope of activities that can be undertaken in the SEZs is much wider and their linkages with the domestic economy are stronger. Resultantly they have a diversified industrial base. Their role is not transient like the EPZs, as they are intended to be instruments of regional development as well as export promotion. As such, SEZs can have tremendous impact on exports, inflow of foreign investment and employment generation.

To provide a stable economic environment for the promotion of Export-import of goods in a quick, efficient and hassle-free manner, Government of India enacted the SEZ Act, which received the assent of the President of India on June 23, 2005. The SEZ Act and the SEZ Rules, 2006 ("SEZ Rules") were notified on February 10, 2006. The SEZ Act is expected to give a big thrust to exports and consequently to the foreign direct investment ("FDI") inflows into India, and is considered to be one of the finest pieces of legislation that may well represent the future of the industrial development strategy in India. The new law is aimed at encouraging public-private partnership to develop world-class infrastructure and attract private investment (domestic and foreign), boosting economic growth, exports and employment.

The SEZs Rules, inter-alia, provide for drastic simplification of procedures and for single window clearance on matters relating to central as well as state governments. Investment of the order of Rs.100,000 crores over the next 3 years with an employment potential of over 5 lakh is expected from the new SEZs apart from indirect employment during the construction period of the SEZs. Heavy investments are expected in sectors like IT, Pharma, Bio-technology, Textiles, Petro-chemicals, Auto-components, etc. The SEZ Rules provides the simplification of procedures for development, operation, and maintenance of the Special Economic Zones and for setting up and conducting business in SEZs. This includes simplified compliance procedures and documentation with an emphasis on self-certification; single window clearance for setting up of an SEZ, setting up a unit in SEZs and clearance on matters relating to Central as well as State Governments; no requirement for providing bank guarantees; contract manufacturing for foreign principals with option to obtain sub-contracting permission at the initial approval stage; and Import-Export of all items through personal baggage.

With a view to augmenting infrastructure facilities for export production it has been decided to permit the setting up of Special Economic Zones (SEZs) in the public, private, joint sector or by the State Governments. The minimum size of the Special Economic Zone shall not be less than 1000 hectares. Minimum area requirement shall, however, not be applicable to product specific and port/airport based SEZ. This measure is expected to promote self-contained areas supported by world-class infrastructure oriented towards export

production. Any private/public/joint sector or State Government or its agencies can set up Special Economic Zone (SEZ).

ADMINISTRATIVE SET UP FOR SEZS:

SEZs is governed by a three tier administrative set up

a) The Board of Approval is the apex body in the Department,

b) The Unit Approval Committee at the Zonal level dealing with approval of units in the SEZs and other related issues, and

c) Each Zone is headed by a Development Commissioner, who also heads the Unit Approval Committee.

APPROVAL MECHANISM OF SEZS:

Any proposal for setting up of SEZ in the Private/Joint/State Sector is routed through the concerned State government who in turn forwards the same to the Department of Commerce with its recommendations for consideration of the Board of Approval. On the other hand, any proposals for setting up of units in the SEZ are approved at the Zonal level by the Approval Committee consisting of Development Commissioner, Customs Authorities and representatives of State Government.

How SEZ's should be modelled to Benefit India:

In India, there are just two or three privately developed SEZ, exceeding 1,000 hectares. Most of the others approved are less than 100 hectares. But it is heartening to realize that the government has decided to up the ante and have made guidelines to have a minimum of 1000 hectares of area for approving an SEZ. It hardly needs reiteration that only a large sized zone can generate economic activity on some reasonable scale. In a small zone, the requisite infrastructure and services cannot be provided nor can multiple economic activities be promoted.

TAX Benefits: The incentive package in India is quite liberal and may even be a shade better than that for Chinese SEZs. In fact, it is more or less on a par with the package for the existing EPZs. Duty free import of capital goods and raw materials, reimbursements of Central Sales Tax, tax holiday for specified period, 100 per cent repatriation of profits for subcontracting facilities are allowed. The Government has done well by extending incentives for the infrastructure sector to zone developers and the units as well. This can attract foreign direct investment for providing internationally competitive infrastructure.

Labor Laws: We can learn from china where initially labor laws where relaxed so that the companies could adopt Hire and Fire policy, once the Private and foreign players gained confidence in the Chinese workers' productivity, this was replaced by the Contract system. India should take cue from this and understand that the import-export business is highly dependent on uncertain international market conditions, rejection of consignments etc. hence a flexible labor policy is the need of hour in the SEZ's.

Domestic Tariff Areas: We got to understand that the reason for the Foreign investors to invest in Industrial, Manufacturing sector in India is not only to cut down on their costs because of cheaper and competitive products but they also see the vast Indian consumer markets, which has seen great income rise and standard of living. So apart from exports itself, the domestic market itself provides immense opportunity for sale of products. The companies in SEZ being levied a full import duty on sale in domestic areas does not seem a bright idea. In this case SEZ's will only promote export driven industries which are highly dependent on import of raw materials. To further make use of full potential of SEZ's Industries which are capable of indigenous generation of raw materials should be provided with tax holidays in terms of benefits to facilitate competitive pricing in the domestic tariff areas.

Thinking about the Future and Possible Fallacies: As evidence over the years has shown, this single-minded pursuit of growth has lowered the efficiency and effectiveness of economic policies, besides incurring huge resource and environmental costs. The Chinese experience offers a valuable lesson for India. Neither the international nor the Indian experience with SEZs has been particularly happy. Globally, only a handful of SEZs, of the hundreds that exist, have generated substantial exports, along with significant domestic spin-offs in demand or technology upgradation. For each successful Shannon (Ireland) or Shenzhen (China), there are 10 failures – in the Philippines, Malaysia, Brazil, Mexico, Colombia, Sri Lanka, Bangladesh, why, even India. A 1998 report by the Comptroller and Auditor General (CAG) on export processing zones (EPZs) says: "Customs duty amounting to Rs. 7,500 crores was forgone for achieving net foreign exchange earnings of Rs.4,700 crores.

The Reserve Bank of India says that large tax incentives can be justified only if SEZ units establish strong "backward and forward linkages with the domestic economy" which is a doubtful proposition. Even the International Monetary Fund's (IMF) Chief Economist Raghuram Rajan has warned: "Not only will [the SEZs] make the government forgo revenue it can ill afford to lose, they also offer firms an incentive to shift existing production to the new zones at substantial cost to society."

As much as 75 per cent of the SEZ area can be used for non-core activities, including development of residential or commercial properties, shopping malls and hospitals. Developers will surely use this to make money via the real estate route rather through export promotion. This represents a potentially humongous urban property racket of incalculable dimensions. India will see a multiplication of "Gurgaon-style" development, under the aegis of big builders such as DLF, Marathon, Rahejas, Unitech, City Parks and Dewan.

Conclusion:

The SEZ's could drastically improve the economic activity in the country, make the country's export competitive and globally noticeable, be net foreign exchange earner and provide immense employment opportunity. But this should not be done at the cost of bringing down the agricultural activities, Land grabbing and real estate mafia should be properly regulated so that the common man is not the net sufferer to get the net foreign exchange earner up and running. As compared to china where majority of the SEZ's were setup by the government, similar should be adopted in India, if not fully it should be a public-private partnership and regulatory bodies should be properly managed to weed out fallacies. To be economically viable SEZ's should be approved over a particular land area (greater than 1000 acres) for rapid economic growth in the area and for it to be profitable and self sustainable. Relaxed Tax norms, Labor laws and DTA regulations will surely attract foreign investment and major industries to setup industries in the SEZ's making it profitable and meeting its desired results!

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