SEZs in India: Past Experience, Current Status and Future Prospects

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Understanding India's Growth Patterns

India's shares of World GDP : Historical perspective

	1700	1820	1890	1952
China	**23.1**	**32.4**	**13.2**	**5.2**
India	**22.6**	**15.7**	**11.0**	**3.8**

Source: Angus Maddison, *Chinese Economic Performance in the Long Run*, Paris 1998, p 40.

World manufacturing 1750-1900
Relative shares of world Manufacturing output

	1750	*1800*	*1830*	*1860*	*1880*	*1900*
Europe	23.2	28.1	34.2	53.2	61.3	62.0
Britain	1.9	4.3	9.5	19.9	22.9	18.5
Habsburg Empire	2.9	3.2	3.2	4.2	4.4	4.7
France	4.0	4.2	5.2	7.9	7.8	6.8
Germany	2.9	3.5	3.5	4.9	8.5	13.2
Italy	2.4	2.5	2.3	2.5	2.5	2.5
Russia	5.0	5.6	5.6	7.0	7.6	8.8
United States	0.1	0.8	2.4	7.2	14.7	23.6
Japan	3.8	3.5	2.8	2.6	2.4	2.4
Rest of the world	73.0	67.7	60.5	36.6	20.9	11.0
China	***32.8***	***33.3***	***29.8***	***19.7***	***12.5***	***6.2***
India/Pakistan	***24.5***	***19.7***	***17.6***	***8.6***	***2.8***	***1.7***

Paul Kennedy – The Rise and Fall of the Great Powers

Structure of GDP and Sectoral GDP Growth Rates in India: 1900-01 to 1946-47

Sector	Structure of GDP(%) at 1948-49 Prices		Annual Growth Rates (%) of Sectoral GDP		
	1900-1909	1940-46	1900-46	1900-29	1930-46
Primary Sector	63.1	51.9	0.4	0.5	0.2
Secondary Sector	12.0	14.4	1.5	0.9	1.2
Tertiary Sector	24.9	33.7	1.7	1.6	1.7
GDP	100.0	100.0	0.9	0.8	0.8

Indian Economy Since independence : Phases in the evolution of government policies:

A. Major Planning Objectives	B. Trade Regime	C. Industrial Regime	D.R&D Policies	E. Foreign Collaboration Policies
Heavy industrialisation based growth (1948-1968)	Import substituting	Regulated	Setting up of R&D infrastructure for creating scientific base	Liberal
Growth with self reliance and social justice (1969-1980)	Progressively import substituting	Tightly regulated	Emphasis on technology and technology development	Restrictive
Growth with efficiency (1980 -1990)	Cautious relaxation	Progressively deregulated	Emphasis on the performance of R&D institutions and their linkages with industry	Cautious relaxation
Growth with international competitiveness 1990 onwards	Increasingly liberal 2003: second phase of liberalisation	Deregulated (Industrial de-licensing)	Emphasis on performance	Increasingly liberal

Average annual growth rates during different phases (%)

	1951-68	1968-80	1980-91	1991-03	2003-07
GNP	**3.69**	**3.21**	**5.55**	**5.46**	**8.78**
PCY	**1.59**	**0.97**	**3.2**	**3.51**	**7.15**
Agriculture	**2.54**	**1.57**	**4.37**	**2.27**	**4.66**
Industry	**5.81**	**4.92**	**6.3**	**5.55**	**8.16**
Manufacturing	**5.58**	**4.95**	**5.68**	**5.71**	**9.71**
Services	**4.73**	**4.12**	**6.26**	**7.08**	**10.04**

Sectoral Share in GDP (%)

	1951-68	1968-80	1980-91	1991-03	2003-07
Agriculture	50.3	41.3	34.7	26.8	20
Industry	13	16.6	18.8	20	19.5
Manufacturing	10.8	13.4	14.5	15.1	15.2
Services	36.3	41.9	46.5	53.1	60.4

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Capital formation and employment

	GDCF as ratio of GDP	GDS as ratio of GDP	Empl. Growth rate	Registered live registration for empl.
1951-1968	13.14	11.36	NA	NA
1968-1980	18.14	17.87	2.56	10.19
1980-1991	23.46	21.3	1.64	27.59
1991-2003	26.43	25.56	0.08	39.11
2003-2007	34.47	34.34	-0.01	40.42

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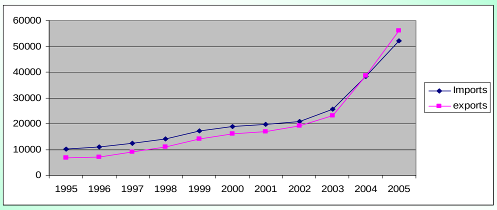
Exports and Imports of services



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Foreign Trade Indicators (Merchandise trade growth rates)

	Exports (% growth)	Imports (% growth)	Non Oil Imports (% growth)	Exports as % of GDP
1970-1980	16.58	21.86	16.17	4.82
1980-1991	8.17	7.78	9.14	5.14
1991-2003	9.71	8.82	8.56	9.06
2003-2007	24.47	32.86	32.27	13.04

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FDI inflows (US $ mill.)

	Govt. approval route	**Automatic**	**M&A**	**NRI's schemes**	**Total**
1991	**78.1**			**66.3**	**144.4**
1992	**187.5**	**18.1**		**58.5**	**264.1**
1993	**339.8**	**78.7**		**189**	**607.5**
1994	**511.4**	**115.6**		**365.1**	**992.1**
1995	**1263.5**	**168.8**		**633.1**	**2065.4**
1996	**1676.9**	**180.2**	**88.3**	**599.6**	**2545**
1997	**2823.6**	**241.9**	**266**	**289.8**	**3621.3**
1998	**2086**	**154.6**	**1027.7**	**91**	**3359.3**
1999	**1473.5**	**181.2**	**466.9**	**83.1**	**2204.7**
2000	**1473.7**	**394.8**	**478.6**	**81.1**	**2428.2**
2001	**2142**	**720.2**	**658.3**	**50.9**	**3571.4**
2002	**1449.6**	**813.1**	**1096.3**	**2.3**	**3361.3**
2003	**933.8**	**508.7**	**636.6**		**2079.1**
2004	**1054.6**	**1178.6**	**980.1**		**3213.3**
2005	**1135.8**	**1557.9**	**1660.5**		**4354.2**
2006	**1533.5**	**7112**	**2465**		**11110.5**
2007	**2586.3**	**8888.5**	**4446.5**		**15921.3**

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Growth rates are high but..

- These are largely attributed to high growth rate in the service sector.
- The share of industry remains approximately 20%. Manufacturing constitutes only 15% of the GDP.
- Capital formation rates have increased but employment generated in the formal sector remains small in this labour abundant country.
- Employment growth in the formal sector is negative.

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In the external sector…

- Exports are increasing but imports are increasing faster resulting into current account deficit.
- Export GDP ratio is and in the world economy, the share of merchandise exports remains almost 1% of the world trade.
- BOS had been negative until recently.
- FDI has increased sharply, in particular during the last two years. In GDP its share is 2.3% and in capital formation it remains 6.42%.
- Actual FDI inflows smaller than potential flows.
- Further, export oriented FDI is small.

Why….

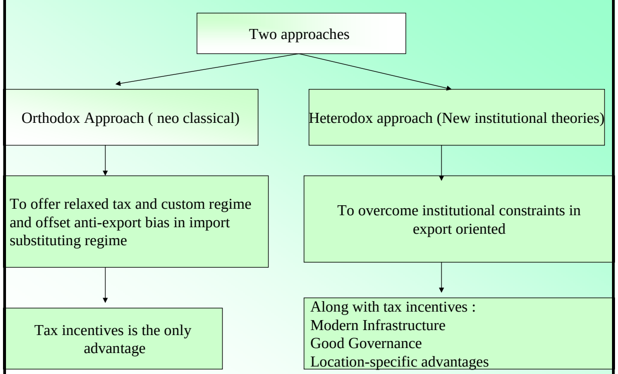
- Structural bottlenecks
- Poor infrastructure, in particular export infrastructure
- Labour market rigidities.
- Poor governance
- Trade rules
- Financial market rigidities
- There is need to address them at the economy wide level. However resource constraint.

Therefore **SEZs** adopted a tool to promote export oriented industrialisation.

- The SEZ Act 2005 followed by SEZ rules w.e.f. 10th Feb, 2006 was introduced to give major thrust to setting up of SEZs.
- With shift in policy regime in most countries, they have become an important policy tool.
- **Table 1 : Estimates of EPZs**

	1975	1986	1995	1997	2006
Countries	25	47	73	93	116
Zones	79	176	500	845	>3000
Employment (million)				22.5	42

Rationale of SEZs : Theoretical Approaches



Benefits from SEZs :

- **1. Orthodox Approach**
- **Neo classical**: Earning Foreign exchange
- Net effect : welfare reducing
- **Cost benefit (or accounting method)** :Warr, 1989
- Direct : foreign exchange ; Indirect : employment and income increase
- Net effect : depends on whether financial costs are less than financial benefits
- **2. Heterodox approach (Johansson 1994)**
- Promotion of industrialisation and economic activity
- Direct :
- indirect effects (through spillovers and demonstrations).
- Difficult to measure

Benefits from SEZs : Theoretical approaches

Three approaches

- Orthodox Approach (neo classical)
  - Earning foreign exchange
- Orthodox approach: Cost benefit method
  - Net Financial flows from SEZs to domestic mainland
  - Increase in Incomes of FOP
- Heterodox approach (New institutional theories)
  - Promotion of EOI, economic activity Employment, technology

Heterodox approach : How SEZs stimulate EO production

Three channels

- Domestic producers: 1.Independent GVC (Seller driven Buyer driven)
- MNCs: Inter-firm Intra-firm .
- Clustering

Benefits

Direct

1. Foreign exchange
2. Employment generation
3. Employment for Females
4. Skill Upgradation
5. FDI
6. Tech. transfers and creation

Indirect

1. Indirect employment
2. Investment in domestic eco
3. Skill spillovers
4. Technology spillovers

1. Ind. growth
2. Productive Diversification
3. Human development
4. Revenue generation for govt.

Quantifiable : *static* :Foreign Ex earnings, Net value addition, I, employ, *Dynamic* : Income generation

Non quantifiable : other direct and indirect effects

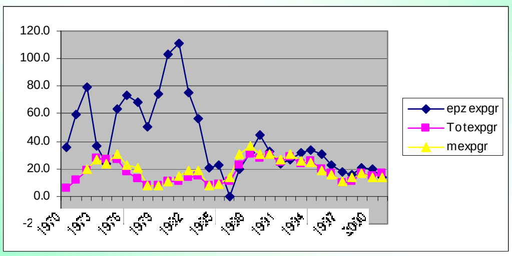
SEZs in India : past experience

SEZs is not a new concept in India….has genesis in EPZ scheme

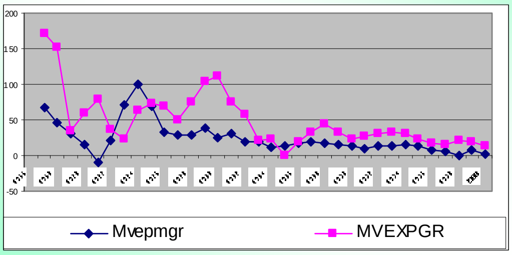
- India: the first Asian country to have an EPZ in 1965. 4 phases of evolution:
- **1965-1984: Initial phase**
- Highly regulatory regime, poor incentive package, Poor infrastructure
- **1985-1990 : expansionary phase**
- 5 new EPZs were set up at Noida, Madras, Cochin, Falta, Vizag
- **1991-2000: Consolidating phase**
- Devolution of powers to zone administration, sectoral coverage was expanded, private sector EPZs, only one zone at Surat came up.
- **2000 -2005 : Transitional Phase**
- Introduction of the SEZ scheme and conversion of EPZs into SEZs.

Poor performance of the zones…

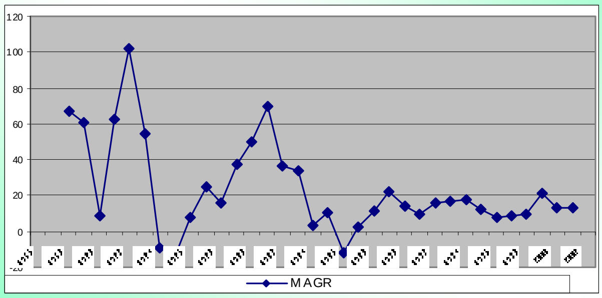
Trends in EPZ, Total and Manufactured export growth rates : 1970-2002



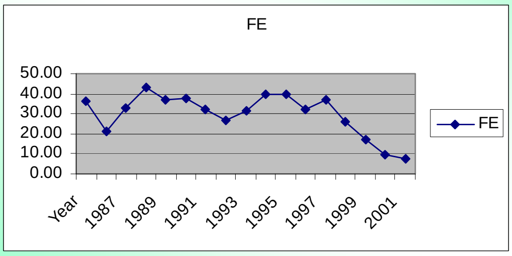
Employment and export growth rates across seven zones in India



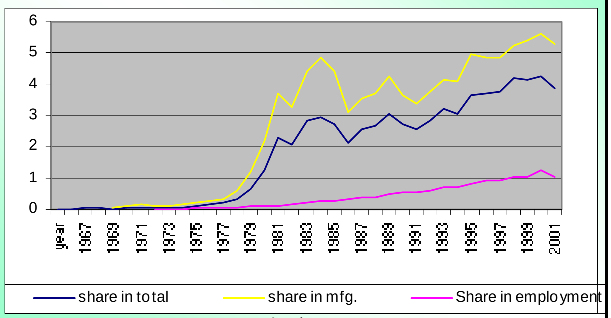
Growth rates of Exports per employee : 1966-2002



Trends in the growth rate of net foreign exchange earnings : 1974-2002



Share in total and manufactured exports



Human development and Poverty

Technology Transfers, creation. And Spillovers limited

Skill formation : Industrial Training, improvement in skill, Better prospects outside.

Remunerative employment for people with low Education level: : comparable wages and Better working conditions, satisfaction levels are higher Living conditions improved after joining the EPZs

Contribution of EPZs to growth : past experience

National Contributio n to exports, employment

Regional development
Contribution to employment,
Income generation
Ancilliary industrial activities
Most notable : SEEPZ, CSEZ, Kandla, Noida

At the sector level significant contribution to technology transfer, spill overs and development of Local entrepreneureship : Gems and Jewellery, Electronics, SW, rubber gloves

EPZs/SEZs failed to pick up because..

- **Relative attractiveness of zones vis-à-vis the domestic mainland had been poor in terms of**
- Governance
- Infrastructure
- Tax incentives
- Appropriate location

Poor meso climate
Poor regional infrastructure and governance

Only Macro level reforms were introduced in 1991. Other factors were neglected

Therefore the SEZ Act, 2005 introduced. ….

- Comprehensive rules and packages for both developers and units.
- No central government SEZs; EPZs by states, private sector and in PPP.
- The coverage of activities extended.
- The concept itself widened to include airport and sea port based SEZs
- Area limits specified: 1000 hectares minimum for multi-product, 100 hectares for one product, 10 hectares for IT, Biotech and Gems and Jewellery etc. (Minimum built up area 100,000 sq. meters for IT, 50,000 sq. meters for gems and jewellery and 40,000 sq. meters for bio-tech.)

Benefits offered : Attractive tax incentives

- (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 : 100% tax exemption for 5 years, 50% for the next 5 years, and 50% of the ploughed back export profits for the next 5 years
- (iii) 100% income tax exemption for 10 years in a block period of 15 years for SEZ developers.
- Exemption from state and local taxes

Improved infrastructure

- Development of world class infrastructure.
- List of infrastructure to develop for developers.
- Development of townships in multi product SEZs
- Infra structure authority in central government zones

Single window clearance

- Powers delegated to Development Commissioners
- Single window clearance by Approval committees.
- Highly simplified custom procedures: exports and imports on self declaration basis.
- Highly simplified rules for domestic procurement and subcontracting
- International subcontracting allowed.

Labour laws

- All labour laws pertaining to trade unions, industrial and labour disputes, welfare of labour including conditions of work, provident funds, employers' liability, workmen's compensation, invalidity and old age pensions and maternity benefits applicable are applicable to SEZs. (SEZ Act Article 49)
- Development commissioners are given the powers of labour commissioners by the state governments
- SEZs are declared as public utility service.

Environment laws

- No environment rules in IT and specified zones.
- All environment rules in other SEZs.
- Approval from state boards.
- Public hearing exemption from units though not for SEZs developers.

Recent patterns

Current status

- 198 SEZs have been notified till date. Over 70 can be said to be operational in terms of the investments and/or employment therein.
- As for production, over 23 newly notified SEZs have commenced exports.
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- Total Investment in new SEZs : Rs. over 670,000 million
- Employment in new SEZs : over 61,000
- Overall increment employment since Feb, 2006 : 143,000.

Inter-regional patterns (share %)

	Notified	Formal	In Principle
South	55.3	40.8	21.5
West	24.1	35.5	39.1
North	15.9	19.1	24.6
East	4.6	7.5	14.5

Sectoral Patterns of notified SEZs

Sector	No.
IT	117
Pharma/Bio	16
Electronics	14
Engineering	14
Textiles	9
Multi products	9
Multi Service	4
Food	3
Footwear	2
Gems and Jewellery	2
Port Based	2
Paper	1
Handicrafts	1
Petroleum	1

Future Prospects

- SEZs can act as catalyst to industrial growth provided they are implemented effectively.
- Some estimates of benefits are calculated.

Net benefits= Economic activity generated

- NNB = (EXP+DTA)-IMP-RM-ELEC-ADMIN-labour cost at shadow price-I cost at shadow price+ premium on FDI+ *premium on land value (not included)+ Net return on infrastructure I*
- Where
- NNB: Net benefits from SEZs
- EXP : foreign exchange earnings and
- DTA : Domestic Tariff area Sales
- **EXP+DTA=Total benefits**

- IMP : imports
- ELEC : the cost of public utilities (electricity, power and fuel)
- RM : the cost of locally purchased inputs
- ADMIN: Administrative costs
- **IMP+ELEC+RM+ADMIN-labour cost at shadow price-I cost at shadow price+ premium on FDI : total cost**

- **Three scenarios:** 100% SEZ investment is additional ; 2. 60% I is additional 3: 40% investment is additional
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Static gains : if 100% additionality of I

	Cumulative exports	Net foreign exchange	Direct net benefits	Tax liabilities	Tax liabilities as % of benefits	Direct employment on account of productive activity	Employment generated in infrastructure in the development phase
ICOR=3.5							
2007-08	22391.42	15345.0	10049.7	2029.0	20.19	90470.4	64056
2008-09	70242.84	48500.8	33940.0	5776.5	17.02	182211.2	90984
2009-10	140515.5	96969.3	69277.6	11029.77	15.92	252126.1	97920
Total	233149.8	160815.1	113267.2	18835.3	16.63	524807.7	252960
ICOR=2.5							
2007-08	23336.55	15649.3	10233.3	2042.0	19.95	94289.11	64056
2008-09	73364.29	49487.5	34531.7	5816.9	16.85	190534.7	90984
2009-10	147110	99023.6	70503.3	11110.2	15.76	264718.4	97920
Total	243810.8	164160.4	115268.3	18969.1	16.46	549542.2	252960
ICOR=0.58							
2007-08	37224.22	21188.2	13796.83	2403.9	17.42	150400.9	64056
2008-09	118763.9	67365.3	45995.3	6963.3	15.14	310953.8	90984
2009-10	242030.4	135995.1	94141.4	13442.52	14.28	443937.0	97920
Total	398018.5	224548.6	153933.5	22809.7	14.82	905291.7	252960

Scenario 3: Three-fourth of the total SEZ production is either relocated from the domestic mainland or is diverted

	Net Benefits (Cr)	Total Tax loss including the notional IT sector taxes (Cr)	Ratio of duty foregone to benefits (%)	Employment in productive (No.)	Infrastructure employment in the development phase (No.)
ICOR=3.5					
2007	1630.854	2029.0	124.41	22617.6	64056
2008	7674.8	5776.5	75.27	45552.8	90984
2009	17047.67	11029.77	64.70	63031.51	97920
Total	26353.32	18835.3	71.47	131201.9	252960
ICOR=.58					
2007	2567.646	2403.9	93.62	37600.22	64056
2008	10688.6	6963.3	65.15	77738.44	90984
2009	23263.63	13442.52	57.78	110984.3	97920
Total	36519.91	22809.7	62.46	226322.9	252960

Dynamic benefits

	Induced and indirect Output generated	total tax Collection on account of productive and infrastructure activities	Tax revenue foregone (Rs. Cr.)	Tax gain Tax gains (Cr.)	**Indirect and induced Employment (No.)**	**Indirect and induced Employment due to infrastructure I in development phases (No.)**
2007	26618.97747	4071.67	2029.0	2042.67	249698	497074.6
2008	87977.63924	8978.28	5776.5	3201.78	502903	706035.8
2009	179063.3552	14600.76	11029.77	3570.99	695868	759859.2
Scenario 3 : 75 percent of SEZ production is diverted/relocated						
2007	64385.58	3664.92	2029.0	1635.96	62425	497074.6
2008	211282.6	7127.80	5776.5	1351.27	125726	706035.8
2009	376643.4	11488.00	11029.77	458.23	230044	759859.2

The great SEZ debate

- Relocation :
- Land Acquisition :
- Loss of agricultural land :
- Impoverishment of farmers :
- Misuse of land for real estate :
- Uneven growth :
- Unequal treatment with exporters :
- A large number of IT sector SEZs :
- **The fact is** that
- Major issues are implementation issues, in particular land acquisition.

However, future will depend on

- The competitiveness of SEZs and their success in attracting investment.

Three types of factors affecting competitiveness

- Micro Climatic
- Meso climatic
- Macro climatic

The policy succeeds in sustaining the momentum if ….

- meso (regional) and macro investment climate is also improved.
- Though micro climate issues are addressed, meso climate is still a problem. Private developers will not really invest in infrastructure development in a major way. It is admitted by the officials.

Thus…..

- Zones cannot be insulated from the broader institutional and economic context of the country. Zones are a part of the economy and require overall improvement in the investment climate to ensure success in the long run.
- The key to the successful industrialisation in the long run thus lies in shaping the existing institutions such that they drive firms towards an outward orientation and technological upgradation; the creation of zones which offer the easy option of competing on the basis of cost minimization.

Conclusion

- Do not politicize them .This is an effort by the government to promote industrial activities.
- The focus should be on how to make them successful and not how to pull the well conceived scheme down.
- Controversies will create uncertainties in the minds of investors affecting the investment flows.
- Land acquisition matter should be resolved by putting effective legislation in place.
- The policy should be transitory.