International Journal of Management and Economics ISSN : 2231 - 4687
Vol. I No. 11 January-March 2014 Impact Factor-1.52

A Perspective of SEZ`s-Five Challenges ahead and Future in India

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INTRODUCTION:

Special economic Zone is a geographical region that has economic laws that are more liberal than a country's typical economic law. 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. Most developing countries in the world have recognized the importance of facilitating international trade for the sustained growth of the economy and increased contribution to the GDP of the nation. As part of its continuing commitment to liberalization, the Government of India has also, since the last decade, adopted a multipronged approach to promote foreign investment in India. The Government of India has pushed ahead with second-generation reforms and has made several policy changes to achieve this objective.

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 is 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. The policy provides for setting up of SEZ's in the public, private, joint sector or by State Governments. It is also being envisaged that some of the existing Export Processing Zones would be converted into Special Economic Zones.

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.

Major Drawbacks:

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. The best example could be seen in the case of farmers from Kalinganagar in Orissa where the money given was disproportionate to as high as 1:10 with respect to the market rates. 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. For example: Nadigram district of West Bengal. But FDI could also help in providing our farmers to gain access to technological better farming methods.

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India and SEZ:

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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.

SEZ Act 2005: 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.

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 modeled to Benefit India:

Size Does Matter: I was reading an article and found out the following fact, China’s SEZs are huge. Shenzhen, the most important SEZ, covers 32,000 hectares. 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 gradation

SEZs - Five Challenges Ahead

Tussle between Commerce and Finance ministry.

While Finance Minister and his team in north block, repeatedly voiced concern over the revenue loss to exchequer on account of tax sops to SEZs, Commerce Minister Kamal Nath and his team have stayed as the most ardent supporters of the policy. Foreign ministry said the government will lose up to Rs 1000 billion in next few years on account of tax sops to SEZs, while the commerce ministry felt these zones could make the exchequer richer by Rs 450 billion annually.

The main concern regarding the setting up of SEZs is related to acquisition of farm land for non-farm purposes. Especially, the concerns raised against a few projects such as Reliance Industries` Haryana SEZ and two SEZs in Maharashtra and Reliance Energy`s Dadri SEZ in Uttar Pradesh.

The Finance Ministry favored a limit on the number of SEZs. Moreover, as SEZs would be foreign territory for customs purpose, the Finance Ministry wanted administrative control. Besides, Communications and IT Ministry under Dayanidhi Maran wanted supervision over SEZs for IT and ITEs sectors.

Challenges: A SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis of SEZ's in India suggests there is significant potential, but many hurdles yet to be crossed:

Strengths

- Familiarity with Western concepts of business practices;
- An established legal redress system;
- Relatively low labor costs;
- India's large English speaking workforce;
- A large and growing domestic market.

Weaknesses

• Indian SEZs will have to comply with all Indian labour laws, giving SEZ's no advantages on labour flexibility or addressing labour indiscipline (a. ray of hope may be that the Development Commissioner of the zone, who is appointed by the Ministry, will double up as the Labour Commissioner, which could cut the time taken to settle labour disputes);

• Unlike India's Export Processing Zones, which can sell up to 50 per cent of their exports in the Domestic Tariff Area (DTA) at half the rates of customs duties, SEZ manufactures can sell in DTA only on payment of full duties. The ability to sell in the DTA would be an important consideration for many Export-oriented units/EPZ/SEZ units, as an insurance against downturns in international markets;

• Poor infrastructure;

• High cost of capital;

• Inadequate institutional support: the continuing lack of integration of the various departments involved such as customs, sales tax, environment and pollution control. Without such integration, single window clearance schemes for SEZs cannot operate.

Opportunities

• To use SEZs to catalyze infrastructure development;

• Realistically establish competitive advantages in SEZs;

• A large NRI base who have traditionally invested less in Greenfield development in India;

• Lower the high transaction /behind the border costs to exporters;

• Tap the advantages of WTO/increase India's small share of world trade;

• To increase investments in core strength areas like IT and software products and services.

Threats

• There are signs of an increasing rejection rate for proposals to establish SEZs. This could be linked to the difficulty in reaching agreement between key ministries involved, especially those involved in export promotion or fiscal policy. This could lead to waning business confidence in SEZs.

• Sops provided to the units in the SEZ's could be disputed in the WTO '(eg, different tax treatment for goods specifically for export could give rise to charges of dumping)

• The performance of SEZs will be monitored by a committee headed by the Development Commissioner and consisting of Director General of Foreign Trade (DGFT) officials and customs authorities will monitor the performance of SEZs. But with opposing interests (reducing tariffs to enhance trade for DGFT, maximizing tariff revenue for customs

• Prospect of even more restrictive labour laws being introduced (eg, 'reservations' for socially disadvantaged groups in private sector jobs).

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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