SPECIAL ECONOMIC ZONES IN INDIA

Anthem South Asian Studies

Other titles in the series

Gaur, Ishwar Dayal
Martyr as Bridegroom: A Folk Representation of Bhagat Singh (2008)
Bandyopadhyaya, Jayantanuja
Class and Religion in Ancient India (2007)
Chakrabarti, Radharaman
India's External Relations in a Globalized World Economy (2007)
Sinha, Dilip Kumar
Natural Disaster Reduction (2007)
Fraser, Bashabi (ed.)
Bengal Partition Stories: An Unclosed Chapter (2006)
CSIRD
Towards BIMSTEC-Japan: Comprehensive Economic Cooperation (2006)
Banerjee, Sashanka S
India's Security Dilemmas: Pakistan and Bangladesh (2006)
Chattopadhyaya, Braj
Studying Early India (2006)
Sen, Satadru
Colonial Childhoods (2005)
Bates, Crispin and Basu, Shubho (eds.)
Rethinking Indian Political Institutions (2005)
Brosius, Christiane
Empowering Visions (2005)
Mills, James (ed.)
Subaltern Sports: Politics and Sport in South Asia (2005)

SPECIAL ECONOMIC ZONES IN INDIA

Myths and Realities

Amitendu Palit and Subhomoy Bhattacharjee

ANTHEM PRESS
LONDON • NEW YORK • DELHI

ANTHEM PRESS
An imprint of Wimbledon Publishing Company
www.anthempress.com

This edition first published in India 2008
by ANTHEM PRESS
C-49 Kalkaji, New Delhi 110019, India
75-76 Blackfriars Road, London SE1 8HA, UK
or PO Box 9779, London SW19 7ZG, UK
244 Madison Avenue #116, New York, NY 10016, USA

1 3 5 7 9 10 8 6 4 2
ISBN-13: 978 81 905835 3 4

Printed at Sanat Printers, Sonepat, Haryana

CONTENTS

ACRONYMS AND ABBREVIATIONS

A&N	Andaman and Nicobar
AD	Authorized Dealers
APIIDC	Andhra Pradesh Industrial Infrastructure Development Corporation
BALCO	Bharat Aluminium Company Ltd
BDO	Block Development Officer
BMP	Bangalore Mahanagar Palike
BoA	Board of Approval
BOO	Build-Own-Operate
BOOT	Build-Own-Operate-Transfer
BTP	Biotechnology Park
CBDT	Central Board of Direct Taxes
CBEC	Central Board of Excise and Customs
CST	Central Sales Tax
DC	Development Commissioner
DGFT	Director General of Foreign Trade
DIPP	Department of Industrial Policy and Promotion
DTA	Domestic Tariff Area
EDZ	Economic Development Zone
EEFC	Export Earners' Foreign Currency
EEZ	Exclusive Economic Zone
EHTP	Electronic Hardware Technology Park
EOU	Export-oriented Units
EPCG	Export Promotion for Capital Goods
EPW	Economic and Political Weekly
EPZ	Export Processing Zone
ETDZ	Economic and Technological Development Zone
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act
FEZ	Free Economic Zone
FICCI	Federation of Indian Chamber of Commerce and Industry
FOB	Free-on-Board
FRBM	Fiscal Responsibility and Budget Management
FTP	Foreign Trade Policy
FTWZ	Free Trade Warehousing Zone
FTZ	Free Trade Zone
FZ	Free Zone

GPPIL	Gujarat Positra Port Infrastructure Ltd
GVMC	Greater Visakha Municipal Corporation
ICRIER	Indian Council for Research on International Economic Relations
ICT	Information and Computer Technologies
IDA	Industrial Disputes Act
IIM	Indian Institute of Management
IISCO	Indian Iron and Steel Company
IPZ	Industrial Processing Zone
IT	Information Technology
ITES	IT-enabled Services
ITP	Industrial and Technology Park
ITZ	International Trade Zone
IZ	Industrial Zone
JV	Joint Venture
LoA	Letter of Approval
MAT	Minimum Alternate Tax
MIDC	Maharashtra Industrial Development Corporation
MoU	Memorandum of Understanding
NAC	Non-Agricultural use Clearance
NALCO	National Aluminium Company Ltd
NCR	National Capital Region
NEIP	North Eastern Industrial Policy
NIPFP	National Institute of Public Finance and Policy
NMSEZ	Navi Mumbai Special Economic Zone
NNP	Net National Product
NPA	Non-Performing Assets
NREGA	National Rural Employment Guarantee Act
NTPC	National Thermal Power Corporation
OBU	Offshore Banking Unit
OIIDCO	Orissa Industrial Infrastructure Development Corporation
PCPIR	Petro-chemical and Petroleum Industrial Regions
PGCIL	Power Grid Corporation of India Limited
POSCO	Pohang Steel Company
PSU	Public Sector Undertaking
PwC	PricewaterhouseCoopers
PWD	Public Works Department
QIZ	Qualifying Industrial Zone
R&R	Rehabilitation and Resettlement
RIL	Reliance Industries Limited

RoK	Republic of Korea
SEEPZ	Santa Cruz Electronics Export Processing Zone
SEZ	Special Economic Zone
SIA	Social Impact Assessment
STP	Software Technology Park
STPI	Software Technology Parks of India
STT	Securities Transaction Tax
TDR	Transfer of Developmental Rights
TDZ	Trade Development Zone
UPA	United Progressive Alliance
UT	Union Territory
VRS	Voluntary Retirement Scheme
WBIDC	West Bengal Industrial Development Corporation
WTO	World Trade Organization

LIST OF TABLES

LIST OF BOXES

LIST OF FIGURES

LIST OF ANNEXURES

PREFACE

The thought of doing a book on SEZs was nowhere in our scheme of things till about a year ago. We were merely following the twists and turns in the SEZ story like most others. By end 2006, however, SEZs ceased to remain academic controversies. As SEZ-related developments became murkier, the debate assumed larger sociopolitical dimensions. Slowly it turned emotional and propagandist. Finally, the story took a fatal turn with violent clashes over SEZs leading to loss of property and lives.

We were shocked by the ugly turn of events. We were also taken aback by the amount of hype being fed into the debate by both its supporters and opponents. In practically all forums, particularly the popular media, SEZs were portrayed as either angels or demons. Somehow, somewhere, the debate on SEZs has compromised heavily on logic and sanity. We also feel that the hysteria and emotion surrounding the debate has been used by some sections for implementing narrow divisive agendas.

As SEZs continued to create ripples and grab headlines, we got increasingly disillusioned by the quality of the debate. Indeed, the rampant rabble-rousing was not only diluting the intellectual content of the discourse, but was also doing grave injustice to the common man by imparting distorted impressions. This is what provoked us into writing this book. We felt it important to examine popular perceptions on SEZs, as thrown up by the ongoing debate, in a dispassionate, factual manner. Such an examination calls for reviewing the roles of different stakeholders involved in the story. We've tried doing so in the pages that follow. We've tried to separate the wheat from the chaff while dipping into sensitive issues like land, finance and political economy. We hope that our readers, many of whom might still be as confused as we were in the beginning, will end the book with a somewhat clearer idea of the enigma called SEZs.

There are many whom we must thank for their support to our effort. We are grateful to eminent economist Professor Bibek Debroy of the International Management Institute (IMI), Delhi, for writing the foreword to this book at a short notice. We thank Professor Sugata Marjit of the Centre for Studies in Social Sciences (CSSS), Kolkata, for his valuable comments and suggestions. We thank Dr Rajiv Kumar, Director, ICRIER, Delhi, Dr Ashok Lahiri, India's Executive Director at the ADB, and Mr Sandipan Deb, Editor, *Financial Express*, for their unstinted encouragement.

The views and submissions of Mr Kamal Nath, Minister for Commerce and Industry, and Mr Yashwant Sinha, former Finance Minister, have provided us with considerable food for thought. We thank them for providing us the intellectual stimulus. We thank Mr C M Vasudev, former Executive Director, World Bank, for his observation of the context in which the SEZ policy was framed. We also thank Mr Arbind Modi, Joint Secretary, Ministry of Finance, Mr Ashok Lavasa, Principal Secretary, Government of Haryana, Mr Yogendra Garg, Director, Ministry of Commerce and Industry, Mr Saumitra Mohan, Additional District Magistrate, Hooghly, West Bengal, Mr Pratapmadi Reddy, Additional Secretary to the Chief Minister of Andhra Pradesh, and Mr Lalit Singhal, Director General, Export Promotion Council for EOUs and SEZs, for their valuable insights. We would like to specially thank the district and block officials of Nandigram in West Bengal for their patient responses to our queries.

Our friends from different walks of the corporate world have provided us with most useful inputs. We gratefully acknowledge the help extended by Dr Krishna Jajodia, Chairman, SEZ Council of Assocham, Mr P KAcharya, Chief Manager, Punjab National Bank, Mr Navin Raheja, Managing Director, Raheja Developers Private Limited, Mr Deepak Dhanak, Senior Manager, PricewaterhouseCoopers, Mr Dilip Chaware, President, Corporate Communications, NMSEZ Development Company Private Limited, Mr Vikas Saran, General Manager, POSCO India Private Limited, Mr Arun Mubayi and Rajamani Krishnamurti, President and General Manager, JSW Steel Limited, and Mr Yogesh Verma, Executive Director, DLF SEZ Developers Limited. We specially thank Mr Pranab Ray for providing us with one of the sharpest possible expositions of the wonderland of SEZs. We can't thank enough Mr Akash Gupt, Associate Director, PricewaterhouseCoopers, who almost led us by hand into the world of SEZ, and Mr R Sridhar, Senior Manager, PricewaterhouseCoopers, who felt that discussing SEZs was a perfectly acceptable way of spending a rare holiday afternoon.

We are grateful to Mr Zheng Han Lin of the Guangzhou Investment Promotion Office, China, and Mr Nicolaus Wilk, Assistant Account Manager, Golin Harris, Taiwan, for their useful views.

This book has made us even more indebted to some of our friends who have gone out of the way to help us. These include Anindya Sengupta, who coordinated the visits to Nandigram and Singur, Dr Partha Mukhopadhay, whom we kept on troubling for inputs on financing models for infrastructure, Arun S, at the Financial Express, who was always ready to discuss the arcane topic, and Mr Partha Pratim Mitra, Economic Adviser, Banking Division, Ministry of Finance, our friend, philosopher and guide all rolled into one – the man with the best smile this side of the Suez.

We thank Mr Kamaljit Sood, Chairman, Anthem Press, Wimbledon Publishing Group for supporting our endeavour. Our special thanks to Mr Abhijit Mazumder, Director Anthem Press-India Operations, without whose encouragement and persuasion, this book would not have seen the light of day. We also thank Mr Indranil Mitra, House Editor, Anthem Press, for his painstaking efforts in editing the manuscript.

Last, but not least, thanks to Parama and Neeta, our wives, and Debolina, for putting up with all our idiosyncrasies with untiring patience. All errors in the book are entirely ours.

Amitendu Palit and Subhomoy Bhattacharjee
31 December 2007

FOREWORD

Zoning Development

The Indian economy is doing well and seems to have broken away from the 6.5 per cent growth trajectory of the 1990s to a 9 per cent growth trajectory, although one can continue to debate whether this is structural or cyclical. This isn't about growth alone, but also about its trickle-down effects. The National Sample Survey (NSS) data for 2004–5 shows a drop in poverty ratios, though not as much as one had originally hoped. Education indicators (gross enrollment in elementary schools) have gone up. Even health indicators show some improvement. This is the India Shining story. But there continue to be concerns about whether these improvements are broad-based enough and whether segments of society are deprived and disadvantaged and are being marginalized in the growth process. This is the concern in the divides and disparities section of the Approach Paper to the 11th Five Year Plan (2007–12). Divides and disparities can be interpreted in different senses, individual or collective, gender, caste, religion and even geography. The geographic identification is usually expressed in terms of a rural/urban dichotomy, but is a bit of an over-simplification. There are States (Bihar, Jharkhand, Uttar Pradesh, Uttarakhand, Madhya Pradesh, Chhattisgarh, Orissa, not to forget the North-East) that aren't doing particularly well. 200 of 600 districts are backward. 125,000 of 600,000 villages have no physical or social infrastructure worth the name. Stated differently, some parts of India are not 'competitive' and what can one do to increase their competitiveness? This is nothing but the provision of urban amenities in rural areas (PURA) or Bharat Nirman idea and gets into questions of where the resources are going to come from. Are they going to be public resources or private ones? Notwithstanding fiscal incentives, private resources don't flow into backward regions until public investments in physical and rural infrastructure perform a catalytic function.

However, if public resources are scarce, one might not be in a position to invest across the board. Since there is a trade-off, should they then be directed at specific sectors or geographical areas so as to make them competitive? This is the old balanced versus unbalanced growth argument. In the export context, should one reduce (or exempt) duties and simplify procedures for selected enclaves, since liberalization across the board isn't politically feasible, even if such reforms are sometimes revenue neutral? The special dispensation doesn't have to be geographically targeted, 100 per cent export-oriented units (EOUs) and the export promotion for capital goods (EPCG) scheme being instances.

But the special dispensation can also be geographical, which is where free trade zones (FTZs) or export processing zones (EPZs) come in. There is no denying that other countries have successfully experimented with FTZs/EPZs, if the criteria used for success are linked to external sector indicators like export growth, FDI inflows and even employment growth. If the present round of special economic zones (SEZs) is differentiated from the earlier round of FTZs/EPZs, one point of difference is private investments as opposed to public ones. But even there, one ought to be careful. Revenue foregone also has opportunity costs and direct figures on public investments are thus under-estimates, because they don't factor in fiscal incentives. However, even with the export angle, two questions remain. First, at a sweeping level of generalization, India's comparative advantage is in labour. Other than export and import procedures (which have been streamlined across the board, except for the important issue of claiming export incentives) and physical infrastructure, the focus ought to thus have been on flexible labour laws in SEZs, as has been the case elsewhere in the world. But there exists a stumbling block there, since the fundamental labour laws can't be changed for SEZs. At best, one can have simplified rules and procedures. Second, one still doesn't have a clear answer as to how one triggers export development in a specific geographical location, with the attendant multiplier benefits. The theory or practice of the growth pole or agglomeration literature doesn't tell us very much about preconditions for success or even the catalytic role of public intervention. At best, special dispensation triggers development if the core already exists. But it is impossible to create a center de novo. There is no automaticity about the threshold of economies of scale and scope being crossed. We still don't know how a Tirupur or a Ludhiana can be cloned, replicated and up-scaled, and one shouldn't ignore the importance of small-scale industry in this.

However, in the present debate, the SEZ issue has got embroiled not in an export market or labour market agenda, but in a land market or broader development agenda. It is a moot point whether this was the best time to initiate an SEZ policy politically, since the agricultural and rural sectors are both in a bit of a mess, with employment generation being a serious concern. Unlike a country like China, India doesn't have a relative shortage of overall land, even of arable land. However, rural development policy requires people to be pulled out of land, the failed enclosure movement in India, so to speak. But the requisite reforms haven't taken place. So we still have 100 million holdings, of which 90 per cent are sub-optimal, though notions of optimality also depend on what part of India that land is located in and what use is being made of that land. There is a problem of dry-land agriculture and living on land is not an issue that affects land-owners alone, but also agricultural labourers. Urbanization in India has been lower than in many other developing countries and has also slowed over the years. India is under-urbanized and development and economic growth will mean greater urbanization, with the inevitability of agricultural land being converted to non-agricultural use. The argument that non-agricultural land should be used for development and urbanization is non-sequitur. Throughout the history of human civilization, development has occurred along rivers, areas that have also been the traditional terrain of agricultural development. One therefore needed a transparent policy for acquisition, compensation and resettlement and rehabilitation. In principle, this is easier to implement for those who have clear titles to land and becomes operationally difficult for those who only earn a living from that land. Life becomes murkier in a State like West Bengal, where non-land-owners have been given recognition that is not quite legal. The short point is that land markets required reform, together with the other bits in the pending agenda of rural reforms. But since this wasn't done, nor even attempted, SEZs came in as an external trigger for change and raised hackles, both because of the non-transparency in decision-making and because of the inequities such development is likely to foster.

This is not an issue that will die down in a hurry. The debate has merely been postponed a bit. Given this background, this is an excellent book, written in a reader-friendly fashion. While academic rigour hasn't been sacrificed, that hasn't detracted from the broader objective of making the book accessible to a broader audience interested in the policy debate. From the global perspective, we quickly move on to Indian SEZs and the issues. The authors rightly conclude that the last word hasn't been said. But as a first word (and I know of no other similar book, as opposed to isolated writings in newspapers, magazines and journals), this is a book I enjoyed reading. And so will every reader.

Bibek Debroy

Chapter 1

WHY ECONOMIC ZONES?

Countries all over the world create fenced-in, geographically delimited 'enclaves' within their sovereign territories. Such enclaves have become known as 'zones' in economic and business parlances. These zones are distinguished from the rest of the land in terms of their specific administrative authority, benefits enjoyed by industries located in them and availability of better business facilities. Some of the zones are often deliberately conceived as 'foreign' territories functioning with a different set of economic laws compared with those applicable to the rest of the country. Being 'foreign' also implies that zones are different customs areas. Depending upon their specific purposes, benefits offered, economic regulations and administrative frameworks, the zones are called industrial zone (or estate), free trade zone (FTZ), export processing zone (EPZ), enterprise zone, special economic zone (SEZ) or free economic zone (FEZ). This taxonomy, however, is by no means fully exhaustive.

Zones should not be construed as products of the current phase of globalization that has been driven by breathtaking advances in information and computer technologies (ICT). Though modern zones can be dubbed as post-Second World War creatures with the first such zone coming up at the Shannon International Airport at Ireland in 1956,[1] there are examples of zones during the mediaeval era, as well as in the early twentieth century.[2] Over time, however, the visions of different countries on these zones, particularly in the developing world, have changed significantly. These changes have been fashioned to some extent by globalization and the resulting transformation in national approaches to development. With almost all developing countries emphasizing on greater trade and investment links, with the rest of the world as their main medium for economic growth and expansion, the design, purpose and structures of zones have undergone several changes.

But why do countries create zones? Ostensibly because they help in selective application of policies. Encouraging exports is one of the main objectives of most zones. Such encouragement is often provided through specific incentives. The latter usually include different kinds of tax exemptions, liberal rules for handling foreign exchange and well-developed logistics and facilities such as warehousing that are typically required by exporters. For many countries, particularly developing economies, it is easier to provide such benefits within a small geographical area, rather than in all corners of their country. This is all the more relevant if benefits include somewhat politically sensitive incentives like flexible labour laws that allow enterprises located in zones to easily shed and recruit people. The proponents of zones argue that these can generate significant economic gains in terms of job creation and human resource development. However, these can occur only over time. Justifying particular incentives and policies for the entire economy by highlighting the anticipated profits is not always easy, more so if the achievements are not immediately visible. The zones offer policymakers softer options in this regard.

The international experience on zones indicates that these have been treated as 'laboratories' for experimenting with radically different policies. China is the best example. The early Chinese SEZs – Shenzhen, Zhuhai, Shanton and Xiamen[3] – were the country's testing grounds for market-based economic policies in a socialist economy dominated by controls. These zones helped China in gauging the virtues of foreign investment and technology, or at least convinced it about the harmlessness of foreign capital. Without these zones, it would have been difficult for China to afford the luxury of carrying out sensitive policy experiments in seclusion. The experience of SEZs encouraged the Chinese authorities to implement liberal foreign investment and import policies in the rest of the country as well.

For producers, particularly exporters, easy access to land, tax benefits, sound infrastructure and an enabling business environment are strong motivations for locating in zones. However, if the best conditions for business can be created within a limited area, why cannot they be reproduced in the rest of the country? This is usually the question that is raised by the critics of the zone model. For developing country authorities, one of the common responses to this criticism is that scarce public resources do not allow growth of such capacities in every nook and corner of the country (IDFC, 2001). Ditto for tax exemptions and employer-friendly labour laws that are likely to arouse political and social discontents. So zones emerge as viable alternatives. In this sense, however, there is little doubt that promoting zones is essentially a 'second-best' choice; something that is resorted to when desired policies could not be applied over larger domains.

How many Zones?

Two types of zones figure the most in economic and business literatures. These are EPZ/FTZ and SEZ. The distinguishing line between the EPZs and FTZs is so thin that we thought it best to club the two together. SEZs, despite having many similarities with the EPZs and FTZs, are distinct in some respects, as we will discuss later. In addition to these two categories, there are industrial zones (or estates) and enterprise zones. The former promote industrial growth by offering facilities such as cheap land for building factories, easy power and water supply, industrial testing and marketing opportunities. These are found all over the world, particularly in developing countries,[4] and are essentially meant for helping small and medium entrepreneurs. The enterprise zones on the contrary have been popularized by the United States of America (USA). These are dedicated to urban development in inner city areas and offer tax incentives to prospective entrepreneurs.[5] However, such zones elsewhere in the world, like in the United Kingdom (UK), have been used for stimulating economic activity and generating employment.

All the zones mentioned above, i.e. EPZ, SEZ, industrial zones and enterprise zones, are usually conceived in line with the interests of specific economic groups such as manufacturer exporters. There are some zones, however, which engage only in services and are not connected to manufacturing activities. Zones specializing in information-technology-based services are typical examples, as are the ones providing different financial and commercial services. However, depending upon the overarching policy framework, these zones can be called SEZs as well. In India, for example, there are specific IT and financial services SEZs, as well as free trade warehousing zones (FTWZ). The latter, according to international practices, is usually branded as a commercial free zone. Such zones again are different from free ports or free zones, which are special customs areas[6] allowing duty free imports. These ports or zones (e.g. Hong Kong, Singapore or Rotterdam) are also ideal facilities for transhipment[7] of goods, as they do not impose any controls on such passage of cargo.

A Useful Typology of Zones is given in Table 1.1.

Table 1.1: Types of zones

	Physical features	Objectives	Incentives	Activities	Example[8]
SEZ	Usually covers a distinct administrative region (e.g. province/ municipality) and is more than 100 sq km in size. Can be located anywhere. Resident population.	Integrated development. Deregulated economic conditions for encouraging private enterprise.	Duty-free imports. Lower business taxes compared with other parts of the country. Liberal labour laws[9] and limited foreign exchange controls.	Multi-purpose. Includes all industries and services. Domestic sales are permitted. But foreign markets and exports are thrust areas.	China (Shenzhen), India (Surat), Philippines (Subic Bay), Poland (Katowicka), Ukraine (Donetsk).
EPZ/FTZ	An enclave or park, usually less than 200 hectares in size. Usually located close to seaports and airports.	Increasing of manu-facturing exports. Broader range of products usually includes light industry and manu-facturing.	Duty-free imports of imported inputs – particularly capital goods and raw materials. Export profits are tax exempted. Liberal foreign exchange rules and labour laws.[10]	Main emphasis is on exports with units having minimum export obligations. Restricted sales in domestic markets.	Bangladesh (Chittagong), Jamaica (Kingston), India (Kandla[11]), Kenya (Athi River).
Industrial zone	Enclave or industrial park. Can be located	Industrial development. Usually targeted at	Similar to EPZs/FTZs.	Producing for domestic market as	Bulgaria (Rakovski), Vietnam (Quang