

Potential Reform of the SEZ Policy and Operating Framework

Comments and Suggestions from CUTS International

The euphoria which was generated in the middle of the last decade on potential positive outcomes of Special Economic Zones (SEZs) on the Indian economy in general and exports in particular seems to have evaporated. Even though the contribution of SEZs to India's exports and also in terms of employment generation continue to be significant, but considering the current trend – widening gap between approvals and actual setting up of SEZs as a result of withdrawing of proposals at various stages – there is no guarantee that the position will be sustained in near future. In addition, there is not much success in respect to multi-product SEZs, which is very critical for the success of India's long term export strategy.

A number of issues relating to operations of SEZs in India have recently become visible. Export obligations, non-renewal of sunset clause and some new taxes, among others, are some of those emerging issues. In addition, wide ranging protests against the procedures followed for land acquisition are further aggravating the problem of operationalisation. Some proposed SEZ sites have already been affected due to land acquisition issues.

Concerned by the recent downturn and taking into account emerging issues and challenges, the Department of Commerce, Government of India has come out with a Discussion Paper to revamp its SEZ policy. It seeks consultation with various stakeholders to make the Policy more inclusive and effective in the emerging socio-economic dynamics of the country.

This Note addresses some key issues/questions raised in this Discussion Paper.

Issues/Questions	Comments and Suggestions
<i>1a) What are the reasons for lack of spread of SEZs to states other than a select few?</i>	<ul style="list-style-type: none">• States usually consider SEZs a central government issue with state having no or insignificant role.• Lack of state level policy and lack of pro-activeness from state leadership.• Export obligations of SEZs make people believe that a SEZ needs sea port, and in absence of this, SEZ might not be successful or might not fulfill its objectives - this belief is reinforced by the fact that <i>out of 143 operational SEZs, more than 125 are in states where there are sea ports.</i>• Studies indicate high correlation among state level socio-economic development, industrialisation and number of SEZ units in a state – this might have some bearing on states' approach to SEZs.• Most of the states in India suffer from lack of infrastructure, particularly trade-related infrastructure, which is believed to be an imperative for success of SEZs.

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<p><i>1b) How can they be addressed? How can SEZ investments be attracted in backward regions within the States?</i></p>	<ul style="list-style-type: none"> • Convincing states to come out with SEZ policy and once that is in place, states need to create a facilitating environment, which can include but not limited to the creation of an Empowered Committee as already done by a few states in India. • The central government needs to convince states and take them into confidence on any issue relating to SEZs. For this purpose, a National Coordination Committee on SEZs should be formed with direct involvement of each states and UTs and such a body should come under the supervision of the Prime Minister's Office. • The central government also needs to initiate assessment of the scope and potential for setting up SEZs in different states, but especially those which are yet to have any SEZ. The category and type of SEZ can also be identified and suggested to states based on their potential and in line with the National Foreign Trade Policy of India, 2009-14. • An enabling environment (particularly relating to trade-related infrastructure such as transport and communication networks) is a major factor that determines the success of SEZs. The centre should support states to create trade-related infrastructure.
<p><i>2. What are the constraints coming in the way of greater manufacturing investments under the SEZ scheme and how can we overcome them?</i></p>	<ul style="list-style-type: none"> • Relative advantages enjoyed by SEZs in terms of fiscal and other incentives vis-à-vis domestic tariff areas appear to have declined because of schemes such as Focus Product Scheme, Focus Market Scheme, Duty Drawback, etc. It is to be ensured that SEZs remain relevant to investors in terms of financial return and for this some additional benefits such as extension of period for tax exemption and/or inclusion of export turnover of SEZ units or SEZ products exported through DTA units into Focus Market Scheme and other such schemes could be provided. • Re-imposition of 18.5 percent of minimum alternative tax may be another important reason for lack of interests in setting up manufacturing units. Such decisions need to be carefully planned, as stakes are high in terms of employment and income generation. • As compared to service sector investments such as in information technology or IT-enabled services, it is not easy to relocate manufacturing investment in adverse situation. The problem is compounded by SEZ exit clause. While the clause specifies that stakeholders with 49 percent stake need approval from the Board of Approval, no request for exit has met with success. More clarity and transparency are needed to deal with such issues.

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<p>3. <i>What are the reasons for lack of operationalisation of many approved SEZs? How can we overcome these problems and what are the incentives and disincentives that can be created towards this end?</i></p>	<ul style="list-style-type: none"> • Frequent changes in policy can be a major factor deterring investors from continuing and making fresh investments in SEZs. • It may be recalled that the SEZ Act, 2005 had introduced profit-linked tax holiday for SEZ units and developers for 15 and 10 years, respectively. The Finance Bill, 2011 appears to have neutralised the tax benefits promised earlier. Even though there is an entitlement to claim credit in respect of MAT it is believed that it might remain only on paper. Such adverse decisions need to be reconsidered. • Considering the quantum of investment and the need for building confidence among investors, it is pertinent that SEZ policy is highly transparent and has a long-term perspective. The policy also needs to be very clear in terms of what it aims to achieve. While keeping units in SEZs free from tax liabilities will reduce government revenue but reduced revenue can be more than compensated by increase in investment, other economic activities, and new employment and income generation.
<p>4. <i>What are the categories of SEZs that should ideally be envisaged? What should be the minimum area requirements in each case and what should be the sectoral broadbanding permissible in each case?</i></p>	<ul style="list-style-type: none"> • There are some categories exclusion which will not significantly affect the scope and potential of SEZs. These categories such as handicrafts, non-conventional and solar energy could be those with small turnover or those which can operate equally efficiently in other places.
<p>5. <i>How can contiguity norms/practices be revised to facilitate easier fulfillment of land requirements without compromising regulatory concerns?</i></p>	<ul style="list-style-type: none"> • Contiguity norms could be made more flexible as availability of land has become a serious issue. • There may not be any need to differentiate between normal and special states/UTs. • There is a need to reassess required areas for SEZs. This should be done category-wise. Though there is a possibility that it might limit the size of units but it is important due to land acquisition. • Reduction in required area could help in easier acquisition of land on the one hand and spread of SEZs more evenly across states.
<p>6. <i>How can vacancy norms be revised to facilitate easier fulfillment of land requirements without compromising the requirement that SEZs should not result in diversion of existing investments from DTA areas?</i></p>	<ul style="list-style-type: none"> • This can be connected with the congruity issue and should be made more flexible. • Additionally, reduction in required area would reduce this problem to a manageable limit.

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<p>7. What should be the norms for permitting social/other infrastructure for dual SEZ / DTA use to balance the considerations of availability of quality infrastructure for SEZ use, viable scale / operation and avoidance of grant of undue benefits for non SEZ purposes?</p>	<ul style="list-style-type: none"> • It is to be ensured that the area identified for setting up SEZs has existing or has at least immediate scope for creating social and other infrastructure which are required for the success of economic activities, both SEZs and DTA. • Considering that SEZs are a major source of not only new economic activities but also generate employment, income, foreign exchange and more importantly the stakes are much higher, the incentives for them should continue to use available social and other infrastructure.
<p>8. How can broad parity be maintained in the quantum of benefits permissible to SEZ units vis a vis non-SEZ exporters? What specific adjustments can be considered?</p>	<ul style="list-style-type: none"> • In order to maintain the attractiveness of SEZs, exporters from SEZs should continue to be incentivised, incentives to non-SEZ exporters should be based on their achievements, measured in terms of export performance as per the current practice.
<p>9. How can better coordination be ensured between the Centre and the State Governments to ensure that elements of SEZ framework related to State level benefits and infrastructure provision etc. are smoothly implemented?</p>	<ul style="list-style-type: none"> • There is a need for some fresh initiatives on SEZs by the central government in consultation with the states. • The formation of a state level system/mechanism to ensure smooth functioning of SEZs should be made mandatory. This is especially needed for those states which are yet to create mechanism such as empowered committee for the grant of various state government approvals to SEZs. • States should create a new division on SEZs under their commerce and industry department. • States must be regularly apprised about the benefits from SEZs, especially in terms of its potential to generate economic activities, employment, income and revenues.
<p>10. How can the SEZ framework attract FDI and other investment by leveraging the large domestic market, within the SEZ framework?</p>	<ul style="list-style-type: none"> • Domestic market can be an effective tool to attract both types of investments – foreign as well as domestic. One of the limitations of SEZ units is their export obligations. Allowing these units to also operate in local market can provide a necessary push to increased investment. Such provisions can substantially reduce the risk of investment.
<p>11. How can various specific operating procedures and processes related to approvals, reporting requirements etc. be simplified and made more transparent and user friendly?</p>	<ul style="list-style-type: none"> • A centralised mechanism including a dedicated portal should to be created at the central level with sections on each of the states. Details of all existing and proposed SEZs in each of the states (including the system of approvals) should be included to make things clear to potential investors.