



SEZs: AN OVERVIEW

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Abstract

The Indian SEZ policy provides for the development of these zones in the Government, private or joint sector. This offers equal opportunity to both Indian and international private developers. The paper proposes to take an overview of the functioning of Special economic zones and attempt to offer suggestions which would act as a platform for future development.

Key words: SEZ, Incentives Government Initiatives.

INTRODUCTION

The Government of India announced the introduction of Special Economic Zones in April 2000 to achieve the following objectives:

- Generation of additional economic activity
- promotion of exports of goods and services
- Promotion of investment from domestic and foreign sources
- Creation of employment opportunities
- Development of infrastructure facilities

Special Economic Zone (SEZ) is defined as "a specifically delineated duty free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs". SEZs are an acknowledgement of the potential of export-led development strategy in accelerating economic growth.

The Indian SEZ policy provides for the development of these zones in the Government, private or joint sector. This offers equal opportunity to both Indian and international private developers. Units may be set up in SEZ for manufacture of goods and rendering of services. The units in the zone have to be net foreign exchange earners but they shall not be subjected to any pre-determined value addition or minimum export performance requirements.

The Government has converted eight Export Processing Zones located at Kandla and Surat (Gujarat), Cochin (Kerala), Santa Cruz (Mumbai-Maharashtra), Falta (West Bengal), Madras (Tamil Nadu), Visakhapatnam (Andhra Pradesh) and Noida (Uttar Pradesh) into Special Economic Zones and all are functional now. In addition, 3 new Special Economic Zones approved for establishment at Indore (Madhya Pradesh), Manikanchan - Salt Lake (Kolkata) and Jaipur have since commenced operations.

INCENTIVES AND FACILITIES TO SEZ DEVELOPER

The incentives and facilities offered to the units in SEZs for attracting investments into the SEZs, including foreign investment include:-

- Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units
- 100% Income Tax exemption on export income for SEZ units under Section 10AA of the Income Tax Act for first 5 years, 50% for next 5 years thereafter and 50% of the ploughed back export profit for next 5 years.
- Exemption from minimum alternate tax under section 115JB of the Income Tax Act.
- External commercial borrowing by SEZ units upto US \$ 500 million in a year without any maturity restriction through recognized banking channels.
- Exemption from Central Sales Tax.
- Exemption from Service Tax.
- Single window clearance for Central and State level approvals.
- Exemption from State sales tax and other levies as extended by the respective State Governments.



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The major incentives and facilities available to SEZ developers include:-

- Exemption from customs/excise duties for development of SEZs for authorized operations approved by the BOA.
- Income Tax exemption on income derived from the business of development of the SEZ in a block of 10 years in 15 years under Section 80-IAB of the Income Tax Act.
- Exemption from minimum alternate tax under Section 115 JB of the Income Tax Act.
- Exemption from dividend distribution tax under Section 115O of the Income Tax Act.
- Exemption from Central Sales Tax (CST).
- Exemption from Service Tax (Section 7, 26 and Second Schedule of the SEZ Act).

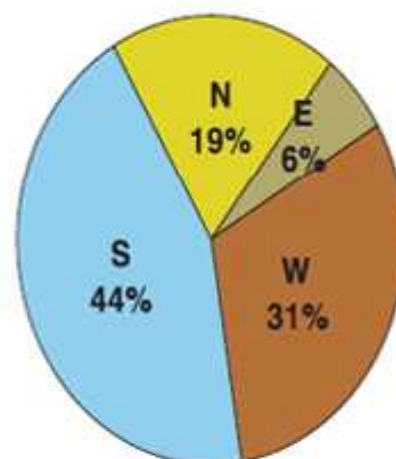
Establishment of SEZ's in India- A few Important Statistics:

The state wise & sector wise distribution of SEZ's in India are given below:

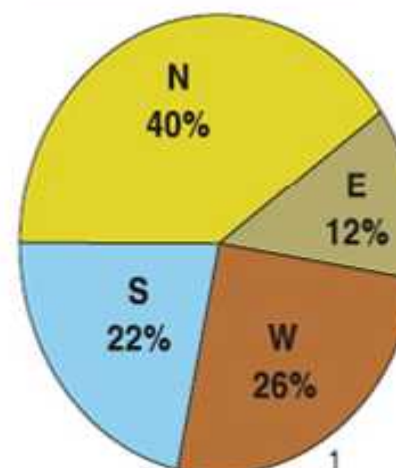
SEZs : Statewise Distribution

State	Formal approvals	In-principle approvals	Notified SEZs
Andhra Pradesh	70	3	54
Chandigarh	2		2
Chattisgarh	1	2	
Delhi	2		
Dadra & Nagar Haveli	4		
Goa	7		3
Gujarat	38	9	17
Haryana	35	17	15
Himachal Pradesh		2	
Jharkhand	1		1
Karnataka	40	10	20
Kerala	11	2	8
Madhya Pradesh	12	5	3
Maharashtra	88	36	24
Nagaland	2		
Orissa	9	4	3
Pondicherry	1		
Punjab	7	8	2
Rajasthan	6	9	4
Tamil Nadu	57	13	30
Uttar Pradesh	23	4	8
Uttaranchal	3	-	1
West Bengal	20	14	6
GRAND TOTAL	439	138	201

Formal



In-principle



Source: Department Of Commerce Annual Report 2009-2008



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SEZs : Sectorwise Distribution

Sectors	Formal approvals	In-principle approvals	Notified SEZs
Aviation/Aerospace		1	
IT/ITES/Electronic Hardware/Semiconductor	275	13	133
Textiles/Apparel/Wool	18	14	8
Pharma/chemicals	19	3	13
Petrochemicals & petro.	1	1	1
Multi-Product	20	51	9
Building product/material	1	1	
Beach & mineral		1	
Bio-tech	20	2	4
Ceramic & glasses	1		
Engineering	16	10	7
Multi-Services/Services	14	8	4
Metallurgical Engineering	1		
Electronic prod/ind	3	4	3
Auto and related	2	5	1
Energy related			
Footwear/Leather	7	2	4
Gems and Jewellery	9	4	2
Power/alternate energy	3	1	1
FTWZ	4	6	-
Metal/Stain. Steel/Alum/ Foundary	6	5	2
Food Processing	4	2	3
Non-Conventional Energy	1		1
Plasting processing		1	
Handicrafts	3	1	1
Agro	3	2	1
Port-based multi-product	6		2
Airport based multiproduct	1		-
Writing and printing paper mills	1	-	1
GRAND TOTAL	439	138	201

Source: Department Of Commerce Annual Report 2009-2008

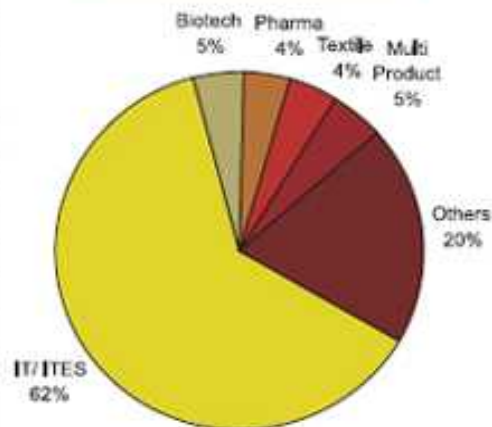
SEZ Act 2005

Special Economic Zone Act 2005 came into force with effect from 10th February 2006, with SEZ rules legally vetted and approved for notification. It is an act to provide for the establishment, development and management of the Special Economic Zones for the promotion of exports and for matters connected therewith or incidental thereto. The SEZ rules provide for drastic simplification of procedures and for single window clearance on matters relating to Central as well as State Governments.

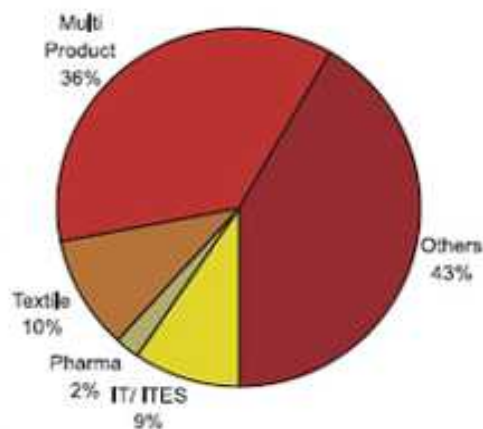
The salient features of the Special Economic Zone Act 2005 are highlighted here:

- Exemption from customs duty, excise duty, etc. on import/domestic procurement of goods for the development, operation and maintenance of SEZs, and the units therein.
- 100 percent income tax exemption for 5 years, 50 percent for the next five years and 50 percent of ploughed back export profits for five years thereafter for SEZ units.
- Exemption from capital gains on transfer of an undertaking from an urban area to SEZ.
- 100 percent income tax exemption to SEZ developers for a block of 10 years in 15 years.
- Exemption from dividend distribution tax to SEZ developers

Formal



In-principle





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- 100 percent income tax exemption for 5 years and 50 percent for the next five years for offshore banking units located in SEZs.
- A provision for setting up of International Financial Services Centre in SEZ has been proposed with the same incentives and facilities as available to offshore banking units.
- Exemption to SEZ developer and units from Minimum Alternate Tax.
- CST Exemption to SEZ developer and units on inter-state purchase of goods.
- Constitution of an authority for each SEZ with a view to providing greater administrative, financial and functional autonomy to these zones. However, no such authority is envisaged for an SEZ established by any person or State Government.
- Establishment of designated courts and a single enforcement agency to ensure speedy trial and investigation of offences committed in SEZs.
- Encouragement to State Governments to liberalize State laws and delegate their powers to the development commissioners of the SEZ to facilitate single window clearance.

GOVERNMENT INITIATIVES TO ENCOURAGE FOREIGN INVESTORS TO INVEST IN SPECIAL ECONOMIC ZONES (SEZ)

- The availability of free trade zones have attracted NRIs who want to set up their businesses in SEZ without facing long procedures and license hassles. Most of the allotment is carried out in the form of single window system which facilitates highly transparent procedures.
- Foreign Direct Investment (FDI) of up to 100 percent under automatic route is allowed for SEZ for all manufacturing activities except defence Equipments, atomic substance, hazardous chemicals, manufactured tobacco substitutes, cigarettes/cigars, brewing of alcoholic drinks, explosives, arms and ammunitions.
- 100 percent FDI is allowed in SEZ for development of township projects including recreational, commercial and housing projects on case to case basis. Foreign companies are also allowed to establish manufacturing units in Indian SEZ as a branch operation on standalone basis without taking prior approval from the Reserve Bank of India.
- The Indian government has enacted the SEZ Act in order to offer stable business environment to domestic and foreign investors. The Act also helped businesses to export/import their goods in extremely efficient, quick and hassle free manner.
- Recently, the Indian Commerce Ministry has taken a team of representatives from SEZ developers and State Governments to the US, Europe, Taiwan, Korea and Japan to generate interest of investors from these countries in Special Economic Zones of India. The ministry has also declared a 'package of reforms' for NRIs to invest in SEZ which involves easing of EXIM policy and land requirement norms to boost interest of investors.
- Because of difficulties in combining large areas of uncultivable land to establish SEZ, the minimum land area requirement has been lowered by 50% for various categories of SEZ in recent times. Henceforth, there would be no minimum land requirement to establish ITeS/IT in SEZ. The Indian government has also permitted ownership transfer of SEZ units besides its sale.
- The tax incentive packages for foreign investors are extremely liberal in India. It is at par with packages offered to existing Export Processing Zones (EPZs). Reimbursement of Central Sales Tax, tax holiday for definite period, duty free import of raw materials and capital goods and 100% repatriation of profits or income for subcontracting facilities are also allowed in India.

GROWTH PROSPECT OF INDIAN SPECIAL ECONOMIC ZONE

India's main advantage lies in its straight policy framework, strong economic growth, availability of skilled workforce, growing domestic market, competitive advantage at global level, better EXIM policy and availability of supportive industries to encourage SEZ growth. All these important factors along with proactive role of the government in promoting SEZ will go a long way in offering the much required momentum in SEZ development. In India, SEZs are considered as industrial townships which offer supporting infrastructure facilities like housing, telecommunication, roads and ports. The range of activities which can be undertaken in SEZs in India are much



wider and their linkage with Indian economy is stronger. In coming years, SEZ will contribute a lot in enhancing the economic activities in India, thereby making the country globally noticeable and export competitive.

INVESTMENT IN THE SEZs

The financing specifications in the SEZ Act and Rules prescribed that a minimum investment of Rs. 1,000 crore and net worth criteria of Rs. 250 crore for the multi-product SEZs. Sector-specific SEZ developers must make a minimum investment of Rs.250 crore or have net worth of Rs. 50 crore. The SEZ Act allows for 100 per cent FDI in the manufacturing sector through the automatic route, barring a few sectors, for establishment of units in the SEZs and also 100 per cent FDI to develop townships within the SEZs. External commercial borrowings of up to \$500 million can be raised by the SEZ units in a year without any maturity restrictions and with flexibility to keep 100 per cent of export proceeds in an EEFC account. SEZ units are eligible to make overseas investments up to any amount under the automatic route to be funded out of EEFC balances of the unit. Such investments will be subject to an overall ceiling of US\$ 500 million. As of December 2008, the total investments in the SEZ units stood at Rs.93,507 crore.

(Per cent)			
Sector	Formal Approvals	Notified SEZs	In-Principle Approvals
1	2	3	4
IT/ITES	61.8	66.1	7.8
Bio-tech	4.7	3.3	0.7
Multi-Product	4.2	4.4	37.6
Engineering	4.2	5.1	7.1
Pharma/chemicals	4.0	5.1	1.4
Textiles/Apparel/Wool	3.6	3.6	9.2
Multi-Services/Services	2.9	1.8	7.8
Gems and Jewellery	1.8	1.1	2.8
Steel/Aluminium/Foundry	1.4	1.1	2.8
Footwear/Leather	1.3	1.5	1.4
FTWZ	1.3	0.4	5.7
Port-based multi-product	1.3	0.7	0.0
Agro	0.9	0.7	2.1
Petrochemicals	0.7	0.4	0.0
Power/alternate energy	0.7	0.7	0.7
Food Processing	0.7	1.1	1.4
Non-Conventional Energy	0.7	0.4	0.0
Handicrafts	0.7	0.4	0.7
Mineral/metals	0.5	0.4	0.0
Electronic products	0.5	1.1	2.8
Auto and related	0.5	0.4	3.5

Source : Compiled from the data available on the SEZ web site of Government of India

Taking into consideration the rules relating to the investments and the business prospective of the SEZs, Gujarat attracted 60.2 per cent of the total investment in the SEZs covering 30 per cent of all SEZ land. One multi-product SEZ in Gujarat accounts for 40 per cent of all SEZ investments. Maharashtra attracted 8.4 per cent investment at the end of March 2008, followed by Tamil Nadu with 8.3 per cent, Karnataka with 7.4 per cent and Andhra Pradesh with 7.2 per cent (Table 6).



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Other States managed to attract only a meager share in total investments in the SEZs. With the increasing number of approvals, the investment flow is expected to be much higher over the coming years along with huge employment that these projects offer. Heavy investments are expected in sun rise industrial sectors such as the IT, Pharmaceuticals, Bio-technology, Petrochemicals, Auto components, etc.

SEZs have to adhere to the following characteristics. SEZs have been useful as pilot zones for trying out reform measures prior to introducing other policy reforms on a country-wide basis and these zones are here to stay. Second, since it is expensive to make high quality infrastructure investments, SEZs have also been used to converge infrastructure investment in a particular geographical area to enable the manufacturing sector to achieve international competitiveness.

Third, SEZs have usually been introduced as export processing zones devoted primarily to production for exports. It is in this context, they are provided duty free status so that they are able to get inputs at international prices which then enable competitive production, and would in turn increase the exports.

Fourth, they have been used to counter anti-export bias in an environment of high tariff. Fifth, SEZs are usually formed to attract private investment and FDI in particular and specially designed for export production.

In the above backdrop, some suggestive policy options are outlined below. Some of the following viewpoints may be necessary preconditions to achieve the desired objectives and to balance the outcome of creation of more SEZs in the country.

- The location of SEZs must be such as to promote manufacturing exports. Linkage to ports and airports should be taken into consideration while setting up the SEZs. Well-developed transport infrastructure may improve the performance of the SEZs even if they are located little far off from these points and then it may not necessary to locate the SEZs very near to the ports/airports.
- Encouragement for modern version of SEZs like free ports, free coastal zones, setting up of growth poles and clusters should be encouraged. The experience of countries like Korea, Japan, Malaysia, Hong Kong, Taiwan and Singapore confirms this.
- Free ports may be far bigger than the SEZs and should offer a world class environment in terms of legal framework, regulatory procedures, infrastructure, production facilities and easy access.
- Offering of greater flexibility to firms in terms of plant location in the zone would encourage the investors' participation.
- Enforcement of good governance in the SEZs with flexible labour laws would be an important component for SEZ success.
- A natural fall-out of successful operations of SEZs is creation of effective forward and backward linkages. It should be noted that just establishing SEZ does not guarantee investment interest, higher industrial activities and exports as experienced in African countries.

The purpose of setting up of SEZs in many countries is the export promotion, technology transfer and thereby generation of more employment and growth. Under the WTO regime, the global economies are better integrated and liberalised to face the emerging competition under the free trade regime. However, many of the EMEs have to promote exports but at the same time they are constrained to safeguard their domestic industry from cheap imports. Therefore, sustaining the SEZ development and thereby increase exports in the competitive environment has to be a core part of development agenda, especially in developing countries.

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