

## Background note Special Economic Zones in India

### Introduction:

India was one of the first in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports, with Asia's first EPZ set up in Kandla in 1965. With a view to overcome the shortcomings experienced on account of the multiplicity of controls and clearances; absence of world-class infrastructure, and an unstable fiscal regime and with a view to attract larger foreign investments in India, the Special Economic Zones (SEZs) Policy was announced in April 2000.

This policy intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations. SEZs in India functioned from 1.11.2000 to 09.02.2006 under the provisions of the Foreign Trade Policy and fiscal incentives were made effective through the provisions of relevant statutes.

To instill confidence in investors and signal the Government's commitment to a stable SEZ policy regime and with a view to impart stability to the SEZ regime thereby generating greater economic activity and employment through the establishment of SEZs, a comprehensive draft SEZ Bill prepared after extensive discussions with the stakeholders. A number of meetings were held in various parts of the country both by the Minister for Commerce and Industry as well as senior officials for this purpose. The Special Economic Zones Act, 2005, was passed by Parliament in May, 2005 which received Presidential assent on the 23rd of June, 2005. The draft SEZ Rules were widely discussed and put on the website of the Department of Commerce offering suggestions/comments. Around 800 suggestions were received on the draft rules. After extensive consultations, the SEZ Act, 2005, supported by SEZ Rules, came into effect on 10th February, 2006, providing for drastic simplification of procedures and for single window clearance on matters relating to central as well as state governments. The main objectives of the SEZ Act are:

- (a) generation of additional economic activity
- (b) promotion of exports of goods and services;
- (c) promotion of investment from domestic and foreign sources;
- (d) creation of employment opportunities;
- (e) development of infrastructure facilities;

It is expected that this will trigger a large flow of foreign and domestic investment in SEZs, in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities.

The SEZ Act 2005 envisages key role for the State Governments in Export Promotion and creation of related infrastructure. A Single Window SEZ approval mechanism has been provided through a 19 member inter-ministerial SEZ Board of

Approval (BoA). The applications duly recommended by the respective State Governments/UT Administration are considered by this BoA periodically. All decisions of the Board of approvals are with consensus.

The SEZ Rules provide for different minimum land requirement for different class of SEZs. Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created.

The SEZ Rules provide for :

- Simplified procedures for development, operation, and maintenance of the Special Economic Zones and for setting up units and conducting business in SEZs;
- Single window clearance for setting up of an SEZ;
- Single window clearance for setting up a unit in a Special Economic Zone;
- Single Window clearance on matters relating to Central as well as State Governments;
- Simplified compliance procedures and documentation with an emphasis on self certification

**Approval mechanism and Administrative set up of SEZs**

- **Approval mechanism**

The developer submits the proposal for establishment of SEZ to the concerned State Government. The State Government has to forward the proposal with its recommendation within 45 days from the date of receipt of such proposal to the Board of Approval. The applicant also has the option to submit the proposal directly to the Board of Approval.

The Board of Approval has been constituted by the Central Government in exercise of the powers conferred under the SEZ Act. All the decisions are taken in the Board of Approval by consensus. The Board of Approval has 19 Members. Its constitution is as follows:

(1)	Secretary, Department of Commerce	<b>Chairman</b>
(2)	Member, CBEC	Member
(3)	Member, IT, CBDT	Member
(4)	Joint Secretary (Banking Division), Department of Economic Affairs, Ministry of Finance	
(5)	Joint Secretary (SEZ), Department of Commerce	Member

(6)	Joint Secretary, DIPP	Member
(7)	Joint Secretary, Ministry of Science and Technology	Member
(8)	Joint Secretary, Ministry of Small Scale Industries and Agro and Rural Industries	Member
(9)	Joint Secretary, Ministry of Home Affairs	Member
(10)	Joint Secretary, Ministry of Defence	Member
(11)	Joint Secretary, Ministry of Environment and Forests	Member
(12)	Joint Secretary, Ministry of Law and Justice	Member
(13)	Joint Secretary, Ministry of Overseas Indian Affairs	Member
(14)	Joint Secretary, Ministry of Urban Development	Member
(15)	A nominee of the State Government concerned	Member
(16)	Director General of Foreign Trade or his nominee	Member
(17)	Development Commissioner concerned	Member
(18)	A professor in the Indian Institute of Management or the Indian Institute of Foreign Trade	Member
(19)	Director or Deputy Secretary, Ministry of Commerce and Industry, Department of Commerce	Member Secretary

#### **(b) Administrative set up**

The functioning of the SEZs is governed by a three tier administrative set up. The Board of Approval is the apex body and is headed by the Secretary, Department of Commerce. The Approval Committee at the Zone level deals with approval of units in the SEZs and other related issues. Each Zone is headed by a Development Commissioner, who is ex-officio chairperson of the Approval Committee.

Once an SEZ has been approved by the Board of Approval and Central Government has notified the area of the SEZ, units are allowed to be set up in the SEZ. All the proposals for setting up of units in the SEZ are approved at the Zone level by the Approval Committee consisting of Development Commissioner, Customs Authorities and representatives of State Government. All post approval clearances including grant of importer-exporter code number, change in the name of the

company or implementing agency, broad banding diversification, etc. are given at the Zone level by the Development Commissioner. The performance of the SEZ units are periodically monitored by the Approval Committee and units are liable for penal action under the provision of Foreign Trade (Development and Regulation) Act, in case of violation of the conditions of the approval.

#### Incentives and facilities offered to the SEZs

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.

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).

#### **SEZ Approval Status**

Consequent upon the SEZ Rules coming into effect w.e.f. 10th February, 2006, Twenty-five meetings of the Board of Approvals have since been held. During these meetings, formal approval has been granted to 462 SEZ proposals. There are 135 valid in-principle approvals. Out of the 462 formal approvals, 222 SEZs have been notified.

#### **Land requirements for approved Special Economic Zones:**

The total land requirement for the formal approvals granted till date is approximately 64222 hectares out of which about 101 approvals are for State Industrial Development Corporations/State Government Ventures which account for over 20453 hectares. In these cases, the land already available with the State Governments or SIDCs or with private companies has been utilized for setting up SEZ. The land for the 222 notified SEZs where operations have since commenced involved is approximately over 28447 hectares only.

Out of the total land area of 2973190 sq km in India, total agricultural land is of the order of 1620388 sq km (54.5%). It is interesting to note that out of this total land area, the land in possession of the 222 SEZs notified amounts to approximately over 284 sq km only. The formal approvals granted also works out to only around 642 sq km.

#### **SEZs- leading to the growth of labour intensive manufacturing industry:**

Out of the 462 formal approvals given till date, 159 approvals are for sector specific and multi product SEZs for manufacture of Textiles & Apparels, Leather Footwear, Automobile components, Engineering etc.. which would involve labour intensive manufacturing. SEZs are going to lead to creation of employment for large number of unemployed rural youth. Nokia and Flextronics electronics hardware SEZs in Sriperumbudur are already providing employment to 13623 and 1272 persons, majority of which are women. Hyderabad Gems SEZ for Jewellery manufacturing in Hyderabad has already employed 2000 persons, out of which 1175 are women, majority of whom are from landless families, after providing training to them. They have a projected direct employment for about 2000 persons. Apache SEZ being set up in Andhra Pradesh will employ 20, 000 persons to manufacture 10,00,000 pairs of shoes every month. Current employment in Apache SEZ is 4750 persons. Brandix Apparels, a Sri Lankan FDI project would provide employment to 60,000 workers over a period of 3 years. Even in the services sector, 12.5 million sq meters space is expected in the IT/ITES SEZs which as per the NASSCOM standards translates into 12.5 lakh jobs. It is, therefore, expected that establishment of SEZs would lead to fast growth of labour intensive manufacturing and services in the country.

#### **Benefits derived from SEZs**

Benefit derived from SEZs is evident from the investment, employment, exports and infrastructural developments additionally generated. The benefits derived from multiplier effect of the investments and additional economic activity in the SEZs and the employment generated thus will far outweigh the tax exemptions and the losses on account of land acquisition. Stability in fiscal concession is absolutely essential to ensure credibility of Government intensions.

**Exports from the functioning SEZs during the last three years are as under:**

Year	Value (Rs. Crore)	Growth Rate ( over previous year )
2003-2004	13,854	39%
2004-2005	18,314	32%
2005-2006	22 840	25%
2006-07	34,615	52%
2007-08	66,638	92%

**(b) Investment and employment in the SEZs set up prior to the SEZ Act, 2005:**

At present, 1819 units are in operation in the SEZs. In the SEZs established prior to the Act coming into force, there are 1122 units providing direct employment to over 1.93 lakh persons; about 37% of whom are women. Private investment by entrepreneurs in these SEZs established prior to the SEZ Act is of the order of over Rs. 7860 crore.

**(c) Investment and employment in the SEZs notified under the SEZ Act 2005:**

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**Current investment and employment:**

- Investment: Rs. 69350 crore
- Employment: 97993 persons

**Impact of the scheme**

The overwhelming response to the SEZ scheme is evident from the flow of investment and creation of additional employment in the country. The SEZ scheme has generated tremendous response amongst the investors, both in India and abroad, which is evident from the list of Developers who have set up SEZs:

- Nokia SEZ in Tamil Nadu
- Quark City SEZ in Chandigarh
- Flextronics SEZ in Tamil Nadu
- Mahindra World City in Tamil Nadu

- Motorola, DELL and Foxconn
- Apache SEZ (Adidas Group) in Andhra Pradesh
- Divvy's Laboratories, Andhra Pradesh
- Rajiv Gandhi Technology Park, Chandigarh
- ETL Infrastructure IT SEZ, Chennai
- Hyderabad Gems Limited, Hyderabad