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Rethinking SEZ policy in India

Special economic zones (SEZs) are demarcated duty-free enclaves from the point of view of customs regulations and these zones are exempt from certain domestic regulations as they are deemed foreign territories. Units in these zones also enjoy single window clearance for all the statutory approvals from central and state governments. Around 140 countries in the world have introduced special economic zones in one form or other to promote exports from their countries. India ranks third after China and Philippines, in terms of the number of SEZs.

The Kandla Export Processing Zone (EPZ), which was set up by the central government in Gujarat in 1965, is the oldest such zone in Asia. Since then, the central government set up six more Export Processing Zones in the country. In order encourage private developers to set up SEZs, the central government introduced SEZ Policy in April 2000 and subsequently SEZ Act in 2005.

Since the enactment of this act, many SEZs have been developed by the private sector. Today, there are 265 operational SEZs in the country, with cumulative investment of more than Rs. 6 lakh crore and which employ around 2 million people across the country. Since the enactment of the SEZ Act in 2005, exports from SEZs have grown at a CAGR of 28% from Rs. 22,800 crore in 2015 to Rs. 7.9 lakh crore in 2019-20. Today, these SEZs contribute more than 20% to the total exports (goods and services) of the country.

Performance during Pandemic

According to sources from the SEZ industry, India's merchandise exports from these zones declined in dollar terms from USD 42 billion in 2019-20 to USD 32 billion in 2020-21 because of the disruption caused by the pandemic. At the same time, it is interesting to note that this decline was caused largely by fall in shipment of gems & jewellery and petroleum products, that together account for 51% of exports from SEZs. There are gems & jewellery SEZs in India that hosts around 500 units. Of the total gems & jewellery exports of the country, units in SEZs contribute 30%. On the other hand, export of manufactured goods (other than petroleum and gems & jewellery) from SEZs grew marginally from USD 16.16 billion to USD 17.3 billion.

Challenges faced by SEZs in India

Although the number of SEZs has increased sizeably after the introduction of SEZ Act in 2005, many of these zones cater to services sector, especially the IT and ITeS sectors. It is argued that India's SEZ policy failed to garner sizeable investment from manufacturing units. There are many reasons given for why India's SEZ Act failed to attract sizeable manufacturing investment. SEZ units complain that although labour laws are relaxed in these zones, they are not as liberal as the labour regulations applicable in China and other foreign countries. Secondly, sale of goods from SEZs to domestic tariff area (DTA) is considered as imports and it attracts customs duty. This makes imports from SEZs uncompetitive compared to concessional duty imports from ASEAN, South Korea, Japan and other countries with which India signed free trade agreements. Thirdly, India SEZs do not have sound infrastructure such as road and port connectivity, which increases the cost of operations in these zones. Also, it is alleged that units in SEZs are not allowed to perform job work for units in the DTA, which prevents them from using their spare capacities optimally. Lastly, the government withdrew the exemption of minimum alternate tax (MAT) on SEZs from 2012, which increased the tax burden on these units.

The concept of SEZs may lose relevance in the coming years as the government has withdrawn income tax exemption on export income of new SEZ units from June 2020. Secondly, India has lost the dispute initiated by USA in WTO on subsidies given to SEZs. Now, India has appealed against the WTO ruling in its appellate body.

Suggestions to promote manufacturing investment in SEZs

In this context, experts have suggested the government to consider the following steps to stimulate manufacturing investment in SEZs. Experts suggest the government to provide subsidy for services inputs used in manufacturing as subsidies given to services cannot be challenged in the WTO. Government may provide subsidy for services such as logistics, R&D, marketing, advertisement and other services that are used by manufacturing units.

Secondly, the government may de-link SEZ incentives from the net foreign exchange earnings criteria (which means exports) and may link incentives to other goals such as creation of employment opportunities, investment in Research and Innovation etc. Under the Agreement on Subsidy and Countervailing Measures, the WTO prohibits countries from giving subsidies contingent on export performance. Therefore, by de-linking SEZ subsidies from the condition of net foreign exchange earnings, the government can change the conditions for providing subsidy to other goals such as employment creation or investment in R&D, which are not prohibited by WTO.

Thirdly, government may allow sale of goods by manufacturing units in SEZs to DTA units by subjecting such sales to tax on the basis of duty foregone principle. Under this principle, the government should collect only that amount of tax which was waived for importing inputs used by the SEZ unit in the process of manufacturing. This, instead of taxing the entire value of the good sold from SEZ to DTA, the government should impose tax only on the imported inputs, which was exempted when the SEZ unit imported those inputs. This will encourage SEZ units to optimally utilise their spare capacity by catering domestic demand when demand in the global market is low.

Government of India set up a committee under the Chairmanship of notes industrialist Baba Kalyani two years ago to prepare roadmap for reviving manufacturing investment in SEZs. The above suggestions are also part of the recommendations of this committee. It is expected that the government will consider these suggestions favourably to revive private manufacturing investment in SEZs in the country.

Notifications

Press Information Bureau

Prime Minister participates in a session at G7 Summit

https://pib.gov.in/PressReleseDetailm.aspx?PRID=1726687

CSIR-CDRI to support Pharma cluster in UP

https://pib.gov.in/PressReleasePage.aspx?PRID=1726214

India promotes mangoes in Bahrain

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