

A study on role of FDI in SEZ - special reference to MEPZ, Chennai

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ABSTRACT: *The SEZs rules, inter-alia, provide for drastic simplification of procedures and for single window clearance on matters relating to central as well as state governments. Investment of the order of rs.100, 000 crores over the next 3 years with an employment potential of over 5 lakh is expected from the new SEZ apart from indirect employment during the construction period of the SEZs. Heavy investments are expected in sectors like it, pharmacy, bio-technology, textiles, petro-chemicals, auto-components, etc. The SEZ Rules provides the simplification of procedures for development, operation, and maintenance of the Special Economic Zones and for setting up and conducting business in SEZs.*

1. Kandla Special Economic Zone, Kandla, Gujarat - Multi product
2. SEEPZ Special Economic Zone, Mumbai, Maharashtra - Electronics and Gems and Jewellery
3. Noida Special Economic Zone Uttar Pradesh - Multi product
4. MEPZ Special Economic Zone Tamil nadu - Multi product
5. Cochin Special Economic Zone Cochin, Kerala - Multi product
6. Falta Special Economic Zone Falta, West Bengal - Multi product
7. Visakhapatnam Special Economic Zone, Andhra Pradesh - Multi product
8. Surat Special Economic Zone, Surat, Gujarat

The current paper explores the role of FDI in special economic zone, with reference to Madras Export Processing Zone - MEPZ, Chennai. It also further discusses fiscal issues and investments, export performance of SEZ units in selected industries and employment generation.

I. INTRODUCTION

The Special Economic Zone – SEZ is a geographical region that has economic laws that are more liberal than a country's typical economic laws. A SEZ is a trade capacity development tool, with the goal to promote rapid economic growth by using tax and business incentives to attract foreign investment and technology. Today, there are approximately 3,000 SEZs operating in 120 countries, which account for over us\$ 600 billion in exports and about 50 million jobs. By offering privileged terms, SEZs attract investment and foreign exchange, spur employment and boost the development of improved technologies and infrastructure.

Special Economic Zones – Indian perspective

There are 13 functional SEZs and about 61 SEZs, which have been approved and are under the process of establishment in India. Most developing countries in the world have recognized the importance of facilitating international trade for the sustained growth of the economy and increased contribution to the GDP of the nation. As part of its continuing commitment to liberalization, the government of India has also, since the last decade, adopted a multi-pronged approach to promote foreign investment in India. The government of India has pushed ahead with second-generation reforms and has made several policy changes to achieve this objective.

Initiation of SEZ in India

the SEZ policy was first introduced in India in April 2000, as a part of the export-import (“EXIM”) policy of India. Considering the need to enhance foreign investment and promote exports from the country and realizing the need that level playing field must be made available to the domestic enterprises and manufacturers to be competitive globally, the government of India in April 2000 announced the introduction of special economic zones policy in the country deemed to be foreign territory for the purposes of trade operations, duties and tariffs. To provide an internationally competitive and hassle free environment for exports, units were allowed be set up in SEZ for manufacture of goods and rendering of services. All the import/export operations of the SEZ units is on self-

certification basis. The units in the zone are required to be a net foreign exchange earner but they would not be subjected to any pre-determined value addition or minimum export performance requirements. A sale in the domestic tariff area by SEZ units is subject to payment of full custom duty and as per import policy in force. Further offshore banking units are being allowed to be set up in the SEZs. The policy provides for setting up of SEZ in the public, private, joint sector or by state governments. It is also being envisaged that some of the existing export processing zones would be converted into special economic zones.

Accordingly the first zone was set up in Kandla (Asia's first EPZ) in 1965. It was followed by the Santacruz export processing zone which came into operation in 1973. The government set up five more zones during the late 1980s. These were at Noida (Uttar Pradesh), Falta (West Bengal) Cochin (Kerala), Chennai (Tamil nadu) and Visakhapatnam (AndhraPradesh). Surat EPZ became operational in 1998. The EXIM policy, 2000 launched a new scheme of Special Economic Zones (SEZs). Under this scheme, EPZs at Kandla, Santa cruz, Cochin and Surat were converted into SEZs. In 2003, other existing EPZs namely, Noida, Falta, Chennai, Vizag were also converted into SEZs. In addition, 3 new special economic zones were approved for establishment at Indore (Madhya Pradesh), Manikanchan – salt lake (Kolkata) and Jaipur and have already commenced operations.

II. COMMENCEMENT OF SEZ IN INDIA

With a view to create an environment for achieving rapid growth in exports, a Special Economic Zone policy was announced in the Export and Import (EXIM) policy 2000. Under this policy, one of the main features is that the designated duty free enclave to be treated as foreign territory only for trade operations and duties and tariffs. No license is required for import. The manufacturing, trading or service activities are allowed. To provide a stable economic environment for the promotion of export-import of goods in a quick, efficient and hassle-free manner, government of India enacted the SEZ Act, which received the assent of the President of India on June 23, 2005.

The SEZ Act and the SEZ rules, 2006 (“SEZ Rules”) were notified on February 10, 2006. The ministry of commerce and industry lays down the regulations that govern the setting up and administering of the SEZs. The central government is functioning, while the state governments play a significant lead role in the development of SEZs in their respective states by stipulating the conditions to be adhered to by a SEZ and granting the necessary approvals. The policy framework for SEZs has been enacted in the SEZ Act and the supporting procedures are laid down in SEZ Rules. The special economic zone act 2005 came into force with effect from 10th February 2006, with SEZs rules legally vetted and approved for notification. The SEZs rules, inter-alia, provide for drastic simplification of procedures and for single window clearance on matters relating to central as well as state governments. Investment of the order of Rs.1,00,000 crores over the next 3 years with an employment potential of over 5 lakh is expected from the new SEZs apart from indirect employment during the construction period of the SEZs. Heavy investments are expected in sectors like it, Pharmacy, Bio-technology, Textiles, Petro-chemicals, Auto-components, etc. The SEZ Rules provides the simplification of procedures for development, operation, and maintenance of the special economic zones and for setting up and conducting business in SEZs. This includes simplified compliance procedures and documentation with an emphasis on self-certification; single window clearance for setting up of an SEZ, setting up a unit in SEZs and clearance on matters relating to central as well as state governments; no requirement for providing bank guarantees; contract manufacturing for foreign principals with option to obtain sub-contracting permission at the initial approval stage; and import-export of all items through personal baggage.

This paper explores the role of FDI in Special Economic Zone, Chennai (MEPZ). It further discusses fiscal issues and investments, export performance of SEZ units in selected industries and employment generation.

III. LITERATURE REVIEW

1. “Quality practices are investment in competitive resources and capabilities which bring competitiveness to the firm, by enhancing reliability, in the eye of customers through superior firm performance” Krajewski and Ritzman (1996), Khalil (2000)
2. “Management capacity as an investment in resources and capabilities makes progress towards competitiveness of a firm”. Priyanto (2006), Verma (2002)
3. “The production capacity and utilisation is an investment in competitive resources that provide competitiveness to the firm by superior performance.” Bavani (2006)
4. “Firms benefit from local production externalities, which exist when a firm's production possibilities depend on the actions of other firms located in the same region.” Hanson (2001), Henderson (2003), and Agarwal (2004).

5. “Vision is one of the abilities of the entrepreneur to steer the firm ahead in the competitions” Vasant Desai (2006)
6. “Providing hassle free environment to run business is one of the objectives of sez exim policy.” Madani (1999) and EXIM Policy (2002-2007), SEZ Act, Ministry of Commerce, India
7. “Ability to procure goods from outside is one of the principal benefits of creating export” Agarwal (2004) and Ministry of India.

Indian experience in implementation of SEZ

The following parameters and sub-parameters are used to project the Indian experience in SEZ.

- Business incentives
- Fiscal benefits
- Provision of infrastructure facilities
- Electricity distribution license & duty exemption
- Freedom to charge tariff for services
- Institutional procedures and transparency
- Comprehensiveness of the proposal
- Approval process
- Single window clearance
- Institutional procedures for sez operation and development
- Environmental considerations
- Social sustainability
- Labour laws
- Employment opportunities
- Land acquisition
- Resettlement and rehabilitation

The Indian experience in the implementation of SEZs has brought to light major areas of concern in the economic factors. In the economic view, these are related to fiscal costs, net employment generation and exports.

IV. FISCAL ISSUES AND INVESTMENT

Tax holidays in the SEZ are generous, and provide 100% exemption for income tax on profits for the first 5 years of production and 50% for the next five years, apart from the tax breaks discussed above. In addition to this, land is given by the government to developers at low rates (Dutta, 2009, p23). Estimates by the finance ministry show that the losses to the state exchequer in terms of forgone revenue would be £24billion for an investment of £50billion (Chandrasekhar and Ghosh, 2007). Owing to the perceived lost revenue, the finance ministry announced a minimum alternate tax on the book profits of developers and units operating in SEZs in the 2011-12 Budget. The commerce ministry, however, wants to see a roll back of this tax and sees SEZs as “engines of growth” (Pannu, 2011). These points express differences between the finance ministry and the commerce ministry on the issue of SEZs. In fact, Arunachalam (2010, p25) shows that the investment as of 2009 in approved SEZs stood at £416million, and not the figures cited by the finance ministry. He argues (2010, p20) that Indian SEZs failed to attract FDI as it would have liked because firstly, India has not used SEZ policies to test reforms which would later be adopted nationwide; secondly, indian sezs are small in size (especially when compared to their Chinese equivalents), and finally, because of the lack of labour market flexibility.

Table 1 : Investment in SEZ

Investment (as on 31st March 2012)	Incremental Investment	Total Investment
SEZs Notified under the Act	US\$ 32.79 billion	US\$ 32.79 billion
State/Pvt. SEZs set up before 2006	US\$ 1.06 billion	US\$ 1.37 billion
Central Government SEZs	US\$ 1.65 billion	US\$ 2.06 billion
Total	US\$ 35.54 billion	US\$ 36.27 billion

Source: Special Economic Zones in India, Ministry of Commerce & Industry, Department of Commerce

V. EXPORTS

The ministry of commerce and industry claimed that the value of exports from functioning SEZs increased from ₹1.9billion in 2003-04 to ₹30.6billion in 2009-10 (exchange rate ₹1 = inr72 as of 16th march, 2011). The growth rate of exports over the previous year's increased from 25% before the SEZ act, 2005 to 52% after its implementation, and it stands at 121.40% in 2009-2010 (SEZ India, 2011a, export performances). Note that these figures are inconsistent with the estimates of losses by the finance ministry. An example of a successful SEZ in this regard would be the Mundra SEZ. This SEZ houses India's largest private port, has been most successful in seeing an increase in exports. It is expected to handle 100m tones of exports by 2013, with a growth rate of 40% in these years (Thakkar, 2008).

However, the Comptroller and Auditor General of India has pointed out that most of the SEZs sell goods within the country as "deemed exports" rather than actually exporting them overseas. This seems plausible as the exponential rise of exports from SEZs corresponds with stagnant national exports. The finance ministry speculates that some units have merely shifted to these zones from the DTA to avail tax benefits (Pannu, 2011).

Sector wise export performance of SEZ/MEPZ indicates that there has been a significant increase in the number of exporting units across zones during SEZ period, thereby supporting the policy framework done by both central government and state government. The following table shows the export values of Madras Export Processing Zone (SEZ) , extracted from directories of MEPZ. The values are expressed in Rs. Crores for the period from 2001 to 2011.

**Table 2 :Exports from mepz sez (rs.in crores) value
Sectorwise exports of sez units for the financial years from 2001-2011**

Years	Engineering industry	Electronic software	Chemical and allied	Leather industry	Food industry	Garments & textiles	Gems & jewelers	Misc. Industries	Total
2001-02	187.75	234.66	66.09	75.38	3.04	162.77	9.71	24.5	763.91
2002-03	195.61	260.83	73.94	79.45	5.91	172.85	14.07	19.41	822.05
2003-04	221.14	291.67	91.22	76.75	2.93	309.65	17.51	60.35	1037.78
2004-05	352.25	394.44	110.88	110.28	1.53	326.45	21.83	48.78	1375.78
2005-06	523.45	532.69	131.11	106.62	7.44	405.7	105.96	46.29	1859.53
2006-07	677.03	634.01	204.8	131.54	18	349.27	321.77	54.93	2382.59
2007-08	753.38	720.09	238.79	152.31	64.85	376.76	685.44	66.54	3046.15
2008-09	1001.42	1088.25	270.72	144.23	80.78	330.39	1040.43	61.44	4022.23
2009-10	779.73	1497.05	287.78	147.27	0	446.68	2561.25	41.43	5788.29
2010-11	373.91	2216.29	133.84	56.81	0	222.55	2461.77	21.09	1931.16

Source: sez india, 2011a, export performances

Figure 1: Exports of Chennai SEZ units, during 2001-2011

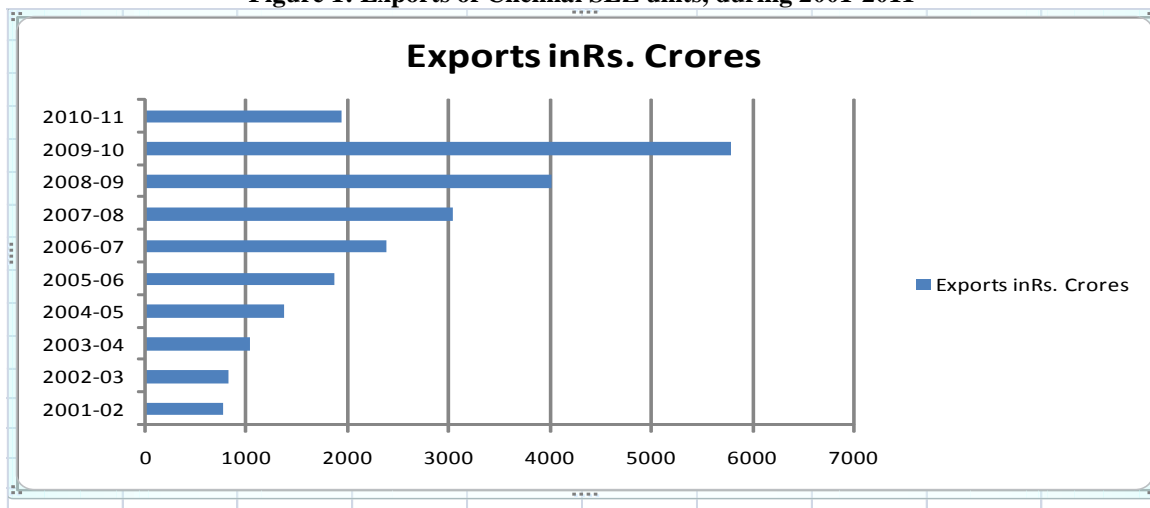


Table 3: Export Performance of SEZs in India

Exports from SEZs				
	2010-11	% of Total production	2011-12	% of Total production
DTA Sale (Counted for +ve NFE)	29093.02	8.11	32472.70	8.00
DTA Sale (Not counted for +ve NFE)	13881.20	3.87	29664.83	7.00
Total Exports	3,15,867.85	---	364477.73	-----

Source: Special Economic Zones in India, Ministry of Commerce & Industry, Department of Commerce

VI. EMPLOYMENT GENERATION

Proponents of SEZs have claimed that SEZs lead to employment generation, in addition to exports. While the total employment by all types of SEZs across India as of 2008 was about 370,000 (Reddy, Prasad and Kumar, 2010, p87), Mahanta (2010, p199) shows that acquisition of agricultural land by SEZs lead to a fall in food-grain output and agricultural employment. Importantly, he shows that this fall in agricultural employment is not offset by the increase in employment in sezs. Another point to note is that compared to countries around the world, Indian SEZs have not seen a high proportion of female workers. In 2003, only 37% of the workforce was female (Varma, Prasad and Krishna, 2010, p320-322). The claims of benefits of the generation of employment by SEZs are hence called into question.

Special Economic Zones of India provide direct employment to over 2,80,832 persons. While the seven central government SEZs provide employment to 1,83,354 persons, the new generation SEZs set up under the new special economic zone policy of 2000 alone employ 97478 persons. Out of this, the share of employment generated by the special economic zones notified under the SEZ Act, 2005 is 61,015 persons. The incremental employment generated in the very short span of time since the act came into force in February 2006, is of the order of 1.46 lakh persons.

Table 4: Employment generation of SEZ in India

Employment(as on 31st March 2012)	Incremental Employment	Total Employment
SEZs Notified under the Act	5,52,048 persons	5,52,048 persons
State/Pvt. SEZs set up before 2006	66,547 persons	79,015 persons
Central Government SEZs	91,617 persons	2,13,853 persons
Total	7,10,212 persons	8,44,916 persons

Source: Special Economic Zones in India, Ministry of Commerce & Industry, Department of Commerce

VII. CONCLUSION

The SEZ Act is expected to give a big thrust to exports and consequently to the Foreign Direct Investment (“FDI”) inflows into India, and is considered to be one of the finest pieces of legislation that may well represent the future of the industrial development strategy in India. The new law is aimed at encouraging public-private partnership to develop world-class infrastructure and attract private investment (domestic and foreign), boosting economic growth, exports and employment.

Table 5: The current status of SEZ in India

Number of Formal approvals	589
Number of Notified SEZs (as on 17 July 2012)	389 (out of 589) + (7 Central Govt. + 12 State/Pvt. SEZs)
No. of Valid In-Principle Approvals	48
Operational SEZs (as on 31/03/ 2012)	153 (Break up: 17 are multi product SEZs, remaining are IT/ITES, Engineering, electronic hardware, textiles, Biotechnology, Gem & Jewellery and other sector specific Special Economic Zones)
Units approved in SEZs (as on 31/03/ 2012)	3,400

Source: Special Economic Zones in India, Ministry of Commerce & Industry, Department of Commerce

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APPENDIX

Operational special economic zones in tamilnadu

- [1]. New Chennai township private limited engineering SEZ: Marg Swarnabhoomi Marg SEZ, seekinakuppam, Chennai, Tamilnadu – Engineering SEZ
- [2]. New Chennai township private limited multi services SEZ: Marg swarnabhoomi marg sez, seekinakuppam, chennai, tamilnadu
- [3]. Shiram properties and infrastructure private limited, Shiram the gateway, Perungalthur village, Chennai, Tamilnadu IT/ITES
- [4]. Tata consultancy services limited Siruseri and Egattur, Tamilnadu IT/ITES
- [5]. Ramanujam IT city, Tril Infopart Ltd., Rajiv gandhi salai (omr),Taramani, Chennai,Tamilnadu
- [6]. ETL infrastructure services limited Tambaram taluk, Kanchipuram, Tamilnadu –IT/ITES
- [7]. Coimbatore hitech infrastructure pvt. Ltd. Coimbatore IT/ITES
- [8]. Synefra engineering and construction ltd. Coimbatore hi-tech Engineering sector
- [9]. Hexaware technologies limited sipcot it park, old mahabalipuram road, siruseri, Chennai, Tamil nadu IT/ITES
- [10]. Sipcot automobile and engineering sez, Coimbatore, Tamil nadu
- [11]. Syntel international pvt.ltd sipcot it park, old mahabalipuram road, siruseri, Chennai, Tamil nadu - IT/ITES
- [12]. DLF infocity developers ltd. Manapakkam & mulivakkam vill., Coimbatore, Tamil nadu IT/ITES
- [13]. Arun excello infrastructure private limited vallncheri and potheri villages, chengalpet taluk, kancheepuram district, Tamil nadu IT/ITES
- [14]. Eta technopark private limited old mahabalipuram road, navallur village, chengalpet taluk,
- [15]. Kancheepuram district - IT/ITES
- [16]. Tamil nadu industrial development corporation limited (tidco) sez, hosur, krishnagiri district, Tamil nadu IT/ITES
- [17]. Electronics corporation of tamil nadu kancheepuram, Tamil nadu IT/ITES
- [18]. Sipcot automobile and engineering sez, perundururai taluk, Erode district
- [19]. WIPRO technologies elcot sez – Sholingnalur, Chennai
- [20]. HCL elcot sez – sholingnalur, Chennai
- [21]. Flextronics technologies (India) private limited sriperumbudur, kancheepuram district, Tamil nadu Electronics hardware and related services
- [22]. State industries promotion corporation of Tamil nadu sipcot industrial area sriperumbudur, Tamil nadu electronics of telecom hardware and support services including trading and logistic activities
- [23]. Textiles special economic zone, perundururai taluk, Erode district
- [24]. Shiram properties and infrastructure private limited perungalathur village, Chennai, Tamil nadu IT/ITES
- [25]. State industries promotion corporation ofTamil nadu Oragadam electronic hardware
- [26]. Cheyyar sez cheyyar footwear Tamil nadu
- [27]. Temple steps