

Way
SEZ's-IN CROSS ISSUES AND OUR A HEAD

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INTRODUCTION

Free trading as an antidote to conventional mercantilism had evolved in the 19th century, even though the principle of free trade was epitomized as a state policy by nations only in the mid 20th century. The domestic policies and tax structure of nations had made them non competitive in the world trade domain. Free trade thus was found to be a panacea, and paved way for an increased inflow of free capital, technology and a larger export market share in the bargain. Special Economic Zones (SEZs) another nomenclature of the same concept, today occupy a predominant position in the World trade scenario with nearly 138 nations encompassing more than 3000 such enclaves contributing around 1600 Billion USD to the world trade kitty.

The generic saga of the SEZs can be explained from the study of the classic projects of Mexican masquiladora, the Puerto Rican free trade policies and in particular the case of the Shannon airport development. The Mexican masquiladora was initiated in the earlier 60s, and was facilitated later by the North West free trade association (NAFTA). masquiladora were set up along the US-Mexican border where these factories were allowed to import duty free raw materials and sub assemblies, to be produced into finished goods and exported back in the next 18 months.

Relaxed custom, wage and taxation laws facilitated nearly 3000 such factories to be set up, for exporting goods which at one stage occupied 25 % of the Mexican GDP and 45% of its exports¹.

On the other hand the development strategy by Puerto rico, was similarly export led. It was called operation bootstrap. Conceptualized by its leader Theodoro Moscoso in the early 20s to replace the agrarian economy, into an industry led economy, the policy allowed foreign capital freely to flow into the country, also allowed repatriation of capital, which in turn encouraged US firms to set shops in Puerto rico resulting in a cascading effect to its economy². Development of more than 100 hectors of land in the northern regions of the Shannon airport as a free zone for attracting European companies to build export led manufacturing facilities was the beginning of the modern day march toward building SEZs world wide. The Shannon development authorities development

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plan was later replicated by many nations, and significant of them was the visit of Chinese officials to Shannon in 1970s⁸ culminating in Deng Xiaoping's open door policy. Initially in 1978 the Guangdong principalities of Shenzhen, Shantou and Zhuhai was declared as SEZs, followed by Xiamen in the Fujian province. The experiment was repeated later in the 80s in declaring additional area near the Pearl River belt as SEZs, which resulted in the quadrupling of the Chinese GDP from 1980 to 2000⁹, from its existing 52 SEZs, resulting in the now famous China growth story.

Whether India's SEZ story is a similar piggy back to that of China, is today a matter of debate and not in the purview of this paper. The India story need to be understood from the time when we started making port based export processing zones in 7 regions viz. Kandla, Mumbai, Madras, Visakhapatnam, Calcutta, Cochin, and Noida. This was a start up effort to increasing India's foreign trade even though myriad problems associated with a controlled economy denied the desired result. However the foreign policy of 2000 with its objective of export maximization gives the necessary fillip by the creation of these 'deemed foreign territories'. The subsequent SEZ Act of 2005 and the SEZ rules of 10th February 2006 put up this direction in a regulated frame work, which now has resulted in 934 no of SEZ in various stages with 272 with notified status at the time of writing this paper¹⁰.

In the above context, this paper, while addressing the critical issues pertaining to the development of SEZ, reviews the development paradigm of the SEZ in terms of the challenges it faces today. Is India's SEZ growth story at cross roads and SEZs in the verge of an antichimax where developers withdraw from the project or is it only a lull in the trajectory of the long gestation SEZ projects. To understand this SEZ as a development model and its complexities need to be reviewed.

CONTRADICTIONS OF AN EXCLUSIVIST MODEL.

Special Economic Zones in India, unfortunately had an inglorious beginning, running into controversies and resulting into media attention and political mudslinging. The issues of land acquisition, revenue losses, and Real estate activity, did result in this imbroglio, with votaries on one hand and critics on the other side.

One of the major critic of the SEZ is it being part of neo liberal policy adopted by the West after the Britton woods agreement in 1944 where free movement of capital, and minimization of the State influence was advocated. It was perceived as an effort for the 'surrender to a minority of investors'¹¹ neglecting the larger issue of labor, state interest etc. It is this critical discourse on the free capital movement which has given the necessary impetus, to view the SEZ development in India as anti-poor and anti-agrarian. The politically backed resistance to the state led land acquisition efforts a la Singur and Raigadh evolves from this background. Loss of agricultural land and creation of land less peasants, Labor exploitation, revenue losses and exploitation of land by a Real estate mafia are all such socio-political issues which was are amply played at various locations.

Inherently this was because of the complexity of the SEZ development model, which unfortunately was not put across in the right prospective.

The complexity of the SEZ development model, is its mutual exclusivity. There are three elements governed by independent laws, viz land and acquisition, Real estate development, and Infrastructure build up. All the three are jointly addressed by a Special Law with a comprehensive tax regime which is today known as the SEZ act 2005.

The Law talks in itself, about a 'Developer' which conceives a development plan and gets an 'in principle' approval, later to acquire land and get it 'formalized', and create an infrastructure, and lease a government 'notified Land' to prospective anchor clients. The developer and his co-developer here, embarks on the process of land acquiring either by private buying or through Government steered acquisition process, which is to be done under the Land acquisition act (LAA). Post, land acquisition, development goes to the infrastructure mode, of building roads, Utility and social amenities where capital formation becomes the focus area.

Thus it could be seen even if there is a comprehensive law (read SEZ act), an inertia exists due to contradictions inherent in the existing laws. This resulted in a opportunist interpretation by politicians, leftist intelligentsia and a cunning median creating a public apprehension and subsequent agitations. The Land acquisition Act (LAA), considered a colonial monster is today the only vehicle for the state governments for acquiring land for large tract SEZs, and the structural problems in the Act as pointed by Morris et al¹² has exasperated the apprehensions.

The second aspect is that of SEZs being a new 'International division of labour' where 'transnational economic space is being carved out, for greater mobility of capital pitted against the immobile labour force'. The cases of Labour insensitivity in SEZs are Highlighted by the Indian Labour Organisation (ILO)¹³ in particularly the regulation of Trade Union activities and the process of 'De-Verticalization'¹⁴ where by major firms concentrate only on the design and marketing of their brand and sub-contract all the manufacturing activities. Rule 48 of the SEZ Rules gives credence to sub-contracting and was argued to be augmenting the deverticalization process.

The third critical element is the so called Real Estate Play. The objection of non processing area utilized by Real estate players for building social infrastructure is being skeptically viewed till recently even by the RBI. The Risk Weightage level of loans to the Real Estate sector is higher and does not equate to that of the Infrastructure project, spearheading a debate of whether the SEZ is a Real Estate project or an Infrastructure project.¹⁵ As per the Basel 11 convention, commercial real estate is defined an asset which is dependent on the cash flows from the mortgage and is a risky investment. The same philosophy was adopted by RBI where the risk to loan is the default from the lessee. SEZs were considered as such a risky investment for bank financing and hence added a high risk weight age unlike an infrastructure project. Thanks to the efforts of

the SEZ featuring the RBI has taken steps to amend the same, considering SEZs as infrastructure project.

Lastly the hue and cry of a favorable tax options in particularly the Corporate income tax loss, resulting in a policy tussle between Ministries necessitating the involvement of the Empowered group of Ministers, for regular policy review sittings. The Ministry of finance arguing on the loss to exchequer and the ministry of commerce talking on the gains of export revenue offsetting the same.

It is in the background of this inertia, that the juggernaut of the SEZ Development model had set sail through, only to face the much higher financial turmoil of today making us think of a cross road whether this effort will bear fruit.

REAL ESTATE LED GLOBAL ECONOMIC DOWNTURN: IMPACT ON SEZs

The present Global economic woes is known to have its genesis in the debt securitization models practiced by Wall Street Investment Bankers on real estate mortgages popularly known as the sub prime crisis. This has exasperated the notion of the Real Estate as a bad boy of the Banking sector. At a juncture when the crisis has hit our shores, creating a credit squeeze in the economy, the formally approved and notified SEZs faces the next challenge. The recent de notification of an IT SEZ of DLF is an example. The formally approved and Notified SEZs have to ensure creation of the necessary and assured infrastructure facility which is achievable only in a low interest, easy available debt structure. In the case of notified SEZ awaiting anchor clients the impact is bipolar in nature. Lack of Funds for Capex expansion coupled by the reduction in capacity utilization of existing facilities has made industries hold on the investments, affecting the Business models and time cycles of the SEZ Developers.

Classical Business Model of the SEZ, involves building infrastructure and leasing the same, and when the lease is not confirmed, the investment starts creating cost overheads. And hence developers prefer a situation of assured returns. On the other hand anchor client's looks into availability of all basic facility in a platter. This indeed has created a chicken and Egg situation, where in developers cry on lack of fund and assured returns on differing investments while clients not able to commence operation till all facilities are ensured.

THE DEVELOPMENT PARADIGM: TACKLING ISSUES

Where do we move forward from this cross road? This is today become a million dollar question on the wake of the withdrawal as reported, of many SEZs like that of DLF, Essar etc. Conceptually, conceived as an enclave to foster economic growth, the concept is apt for our development. The first issue of the Land acquisitions to a larger extend has been addressed by the new rehabilitation policy guidelines, even though the problem of land acquisition is still at large. The panacea to this imbroglio, is to adopt a modular developmental model for the SEZ. The government needs to ensure that the notified areas are fully developed and leased before giving additional notification.

The development of an SEZ processing area should be on an approved model which can be replicated. This would give the necessary confidence in ensuring that the conceived objective is achieved silencing the critics. Presently large tract SEZ approvals have been given including notified status with out a clear developmental goal and its progress monitoring. This has resulted in developers approaching the State government for land, and they intern apply pressure on the owners for acquisition, creating a vicious cycle of resistance and project delay. Instead as stated above the SEZ act should be amended in a way that notification is a precondition to development where a specified minimal area is notified for modular development and additional notification issued only after that area is totally developed and leased.

Development of a model area is an important tool in accessing the impact of the policy and development. It also helps the land holders in experiencing the trickling down effect of development into the country side and neighborhood. It is high time that our policy makers realize that unless the fruit of development is experienced, the application of archaic land acquisition laws will only result into a socio-political backlash.

The other issue of international division of labor and its exploitation was propounded by the ILO itself based on negative effects in few EPZs in Africa and Latin America and cases of income inequalities from Chinese SEZs. There has been a case of labor exploitation in few of the SEZs world wide, but citing them as to be replicable in India is out of order.

This has been addressed recently by ICRIER¹² which has set aside lot of debates in the back burner. As aptly argued in this report 'different aspects of human development is woven together and some aspects are overemphasized and while others are neglected'. Opportunistic intellectuals and politicians have found meat in these conflicting arguments and clamor against liberal labor laws in the SEZ. The amendments to the Labour policy undertaken by some wise state governments like Gujarat, has only made the SEZ a public utility service, making trade unionism and labor agitation as conditional. It has never undermined the labor laws, but has only made it under the purview of the Development commissioner, the single window authority. This will result in the avoidance of the inspector raj and the interference of the labor commissioner and makes Development commissioner accountable to labor issues. It is only an administrative frame work for hassle free operation of the industrial unit but not change of law per se.

Thirdly the social and other infrastructure facility in the non processing area of the SEZ, was considered as a necessity for large tract SEZs for the reason that an industrial development of this large scale, will involve a population expansion, requiring adequate facilities like schools, residential and shopping complexes etc. and catapulting the same as a real estate play is only an apprehension and it has to be acknowledged that Real estate intervention in the SEZ is a sine-qua-non for its success. The large SEZs are planned in far off places and migration of population is possible only if there are social infrastructure facilities.

WHERE TO GO FROM THE CROSS ROAD

As revealed in the Chart 1, the contribution of the best 5 export led nations' export performance contributes 191.2 Billion USD. This comes from 847 zones and compared to India's 2.19 Billion dollars of export from SEZs, convinces us to refocus on its export objectives and SEZ development model as to be viewed as part of this refocusing effort. India is a typical example of a nation which shows a tremendous gap between, foreign Trade realization and its Trade capacity. Considering a growth of above 8.5% we have a tremendous capacity in technology and recourses to compete and occupy a larger share of the world trade, from the abysmally low figure of less than 1% today. Similarly on the employment front the numbers are bound to improve, if the trade and capacity gap is minimized. While writing this paper there are 272 notified SEZ with nearly the same in the 'formal' pipe line (Chart 2), and considering at least 100 SEZs to be fully functional by 2015 we can extrapolate (Table 1) and expect an employment of 12 million and an export of 12 billion USD, even in conservative estimates.

Chart 1: Major Free Trade Zone Nations: (Source WEPZA)

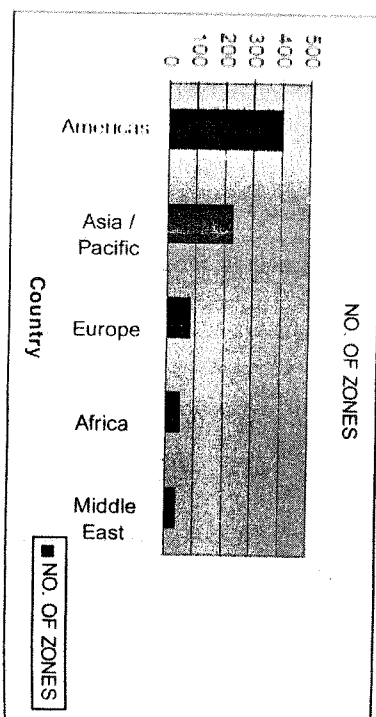
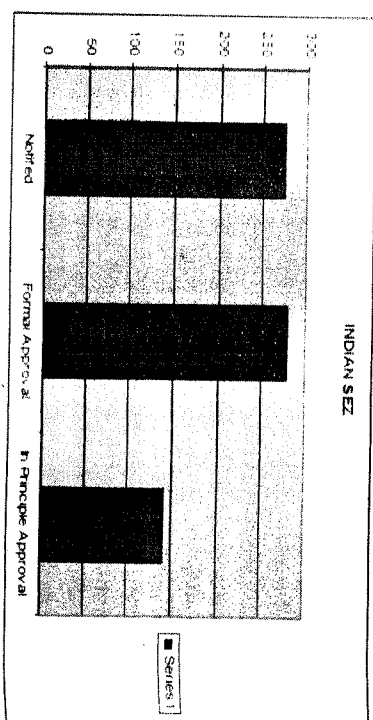


Chart 2: SEZ Status (Source Ministry of Commerce, Govt. of India)



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Table 1
Employment and Export Projections

No of actively functioning SEZs	19
Employment	0.3 million
Export	2.2 billion USD
Employment per SEZ	12539
Export per SEZ	0.12 billion USD
Employment 100 considering fully functioning SEZ by 2015	12.5 million
Export considering 100 fully functional SEZ by 2015	12 billion

Irrespective of the slow down and downturn witnessed now, it is expected a manufacturing capacity addition boom is bound to come where SEZs will play a major role. Industry can bifurcate its domestic and export production in the DTA and SEZ respectively. The capacity additions world over can also be canalized and attract FDI into the SEZs, making Indian SEZs the manufacturing base of the world, creating a reverse brain drain.

MESSAGE OF THIS PAPER

The Policy experimentation has been taking place in our country, due to change of objectives concurrent to change in world economic order. The various schemes adopted by the government at different times where to address these challenges. The globalization of the economy, created a positive effect of flow of capital into India, providing an opportunity to capitalize the effect and SEZ policy has been in that direction. However the current economic slow down, hit the Indian shores and showed a significant impact, with deceleration of the economic indices in particularly the export led indices. This has created a cross road as far as progress of the SEZ development model is concerned. In the background of the critical discourse of the policy, the paper viewed the debate and brought the issue of Trade and Trade capacity gap in India and the role of SEZ in filling the gap.

Unless we are united and positive in making these large gestation projects successfully fructify, the blocks in the Road ahead is bound to stay.

NOTES

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