POLICY BRIEF 9
MARCH 2013

CHANCE 2 SUSTAIN

Is India's Special Economic Zone Policy Sustainable?

By Loraine Kennedy

Over the last 20 years India has gradually opened its economy to trade and investment. The Special Economic Zone (SEZ) Policy, converted into a national law in 2005, is interpreted as an expression of the ongoing reform agenda. The policy has generated considerable controversy, crystallising debates about the sustainability of the country's current development path. Three core issues are:

1. ***loss of land and rural livelihoods in the case of large-scale projects;***
2. ***limited employment generation, given the relative importance of capital-intensive production;***
3. ***spatial concentration of zones around large cities, contributing to regional inequalities.***

These social and spatial implications will be briefly examined here. It is first useful to situate this policy in relation to global trends involving zoning technologies.

Export processing zones are defined by the International Labour Organisation (ILO) as "industrial zones with special incentives set up to attract foreign investors, in which imported materials undergo some degree of processing before being (re-)exported again". Also known as Free Trade Zones, these zones have expanded throughout the world in the last 20-30 years and are seen as emblematic of globalisation processes. Whereas they were present in 25 countries in 1975, by 2007 that number had risen to 130. The number of zones over the same period increased from 75 to 3500. In 2007 total employment in EPZs was estimated at 66 million (of which 40 million in China).

Precursor *and* latecomer to zones

India was both a precursor and a latecomer to such zoning instruments. Although it was the first Asian country to set up zones in the 1960s, this policy was not pursued purposefully. Only eight such first-generation zones were created. Except for one private zone, all were set up by the central government. The results were not compelling: they contributed only 1% of factory employment and about one third of 1% of manufacturing investment in 2005.

In 2005, inspired by the Chinese example, the Indian Parliament passed a new law creating Special Economic Zones (SEZs) and announced their strategic importance for putting exports and foreign direct investments (FDI) on a fast track. The policy's main objectives were to enhance the country's industrial infrastructure, create jobs and balance the trade deficit by boosting exports. In contrast both to India's earlier policy and China's zones, the basis of the new policy is private sector development. Offering a series of incentives and a single-window mechanism to zone promoters as well as to firms setting up inside the zones, the policy hoped to attract capital and benefit from technology

SEVENTH FRAMEWORK PROGRAMME

transfers. Benefits include exemptions from import and export duties, excise and sales taxes, and up to 15 years of tax holidays on profits.

The rationale behind this policy: private promoters will bring the know-how to develop state-of-the-art industrial infrastructure and logistics that firms are looking for. In addition to the processing area, promoters are allowed to develop non-processing areas for residential or commercial purposes, which means these zones can become private townships. This provision has proved to be a powerful incentive, and one with equally powerful spatial repercussions as we shall see below.

Seven categories of SEZs, each with differing rules and varied land requirements

Depending on the type of zone —there are 7 categories— the Indian law stipulates minimum size restrictions. Whereas the minimum area for multi-product zones must be at least 1000 hectares, for some specific single sectors zones, including those for Information Technology and computer services (IT), it is only 10 hectares. As of today, a majority of India's SEZ proposals are for the IT sector and are small in size, and most of those functioning are hardly different in appearance from an IT business park. This is a major difference with China's SEZs, which tend to be very large.

Investor enthusiasm but controversy on the ground

The SEZ policy received an enthusiastic response from private firms and by June 2012 there were 587 formally approved zones, of which 380 were "notified", meaning they had obtained all the required clearances and could start operations. In terms of export performance, there has been a rapid increase in exports from SEZs and their share in total exports was 18% in 2010, up from 3% in 2005.

Table 1: Exports from India's SEZs

Years	Growth Rate (year-to-year)
2006-2007	52%
2007-2008	93%
2008-2009	50%
2009-2010	121%
2010-2011	43%

Source: Govt of India, Dept of Commerce, SEZ Review, consulted 22.11.2011.

Despite this apparent success, SEZs have been controversial for various reasons. One major reason is that SEZ development has led to a loss of land and rural livelihoods. SEZs, which require plots of contiguous land, are often located in rural or periurban areas where land prices are relatively cheap. They introduce risks for rural livelihoods, especially for landless labourers, who cannot easily find other opportunities and who lack the skills for finding employment in manufacturing or service-sector jobs that are created within the zones. An additional problem has arisen around the issue of fair compensation for landowners and other stakeholders. Property rights are not always clearly defined in India: farmers may not hold legal titles to the ground they till, nor livestock breeders and forests dwellers for the lands they make use of for their livelihood. Moreover there are numerous cases of collective ownership, especially in the case of indigenous "aboriginal" groups. In this context, it is difficult for private SEZ promoters to purchase land on the market, and so they turn to public authorities for assistance. In many such cases, state (provincial) governments, eager to attract new investments, are willing to intervene. Under India's federal set-up, states are in charge of land issues and existing legislation (notably the Land Acquisition Act of 1894) allows them to forcibly acquire land for "public purpose", a category that leaves wide discretionary powers. This pro-active role of the state, seen to be taking the side of industry vis-à-vis agriculture, has caused much resentment. Even when the state does not directly transfer land to private parties, it can provide strategic assistance to firms trying to purchase land by deploying the police or turning a blind eye when other forms of pressure are exerted to coerce recalcitrant farmers to sell or disperse protestors from a building site. This is why in most cases of protest, anti-SEZ activists target the state, accusing it of taking the side of private corporate houses, Indian or foreign, against the interests of the public. This was the case in Nandigram in West Bengal where local farmers and tenants refusing to give up their land clashed with police in March 2007 leaving 14 people dead.

The Nandigram incident shocked the country and the central government quickly announced a series of policy revisions. These included directing state governments to refrain from helping private promoters to procure land, urging private firms to avoid purchasing fertile agricultural land, and lowering the ceiling on multi-product SEZs from 10,000 hectares to 5000 hectares. Still some state governments continue to acquire lands with a view to building up a "land bank" so that they can propose plots to prospective investors. Since investment procedures were eased in the 1990s, states tend to compete with each other for new capital and SEZs are no exception. In such a context, social and environmental considerations take second place.

City-centric location patterns and growing social inequalities

Widening regional inequalities, both between and within states, is another contentious issue surrounding SEZ policy. There are no geographical restrictions on where SEZs can locate nor incentives to set-up in less-developed areas and so, not surprisingly, proposals have concentrated in the most developed regions of the country where infrastructure quality is the best. Approximately 75% of formally approved projects are located in just six states (out of a total of 28). These are India's most industrialised regions; with the exception of Haryana in North India, which surrounds metropolitan Delhi on three sides, the other states are in the relatively prosperous regions of the South (Andhra Pradesh, Karnataka, Tamil Nadu) and West (Gujarat, Maharashtra). In terms of SEZ performance too, these five states accounted for 96 per cent of exports in 2009.

In fact, most SEZ projects are very small in size - 70% are less than one square kilometre - and are located in and around metropolitan cities. The strong presence of real estate developers among SEZ promoters has reinforced the impression that the SEZ legal framework allows tax breaks for lucrative commercial and residential developments, for which there is strong demand in cities, without necessarily promoting productive activities. The SEZ policy is expected to contribute to accelerating urbanisation; initial projections by the National Institute of Urban Affairs estimated that between 50 and 70 satellite cities would spring up around SEZs, each with a population of 500,000 to one million.

In this context, it should be noted that already India's urban centres have been the main sites of the rapid growth of the last few decades, and the urban upper and middle classes have been the major beneficiaries. Fast-growing inequalities between rural and urban areas and between the richest and the poorest income groups have started to grab the attention of policy-makers who worry not only that limited demand may diminish the scope of India's economic take-off but that social conflict could jeopardize the reform agenda. To the extent that the SEZ policy appears to aggravate inequalities, it could become a political liability in a democratic set-up like India's.

Yet another criticism is that SEZs are not creating a new manufacturing base since almost 70% of total SEZs are in the IT sector, where India's capability was already established. Although the IT sector is performing very well, it does not absorb large quantities of labour especially low skilled labour, which is abundant. Creating new employment is perhaps India's most crucial challenge if it is to realize a peaceful transition from an agrarian-based society to an industrial- and service-based economy.

The global financial crisis has dampened enthusiasm for SEZ development by sharply reducing international demand for exports. Construction on many projects has slowed down or stalled, and several promoters have requested de-notification of their SEZ projects. In some ways, it looks like the SEZ experience is losing steam even before it could reach cruising speed. However, it is still too early to tell and an upswing in international demand could modify the picture.

The aim of this brief analysis has been to highlight the various issues surrounding India's recent SEZ policy. Although free trade zones have emerged across the planet as an instrument for engaging with globalisation, the discussion here has highlighted some of the negative impacts that can arise. By raising serious questions about the social, spatial and economic sustainability of the SEZ policy, it invites policy-makers to take a critical view of zoning technologies.

For further reading:

Aggarwal, Aradhna. 2006. "Special Economic Zones : Revisiting the Policy Debate." Economic and Political Weekly 41(43-44):4533-4536.

Aggarwal, Aradhna. 2012. Social and Economic Impact of SEZs in India. Delhi: Oxford University Press.

Government of India. n.d. (2011). "Discussion Paper to Facilitate Stakeholder Consultation on Potential Reform of the SEZ Policy and Operating Framework." ed. Department of Commerce SEZ Division, URL sezindia.nic.in/writereaddata/updates/sez_review.pdf consulted 22 November 2011.

Grasset, Jérémy, Landy, Frédéric (2007) Les zones franches de l'Inde, entre ouverture à l'international et speculation immobilière. Annales de géographie, n° 658, pp. 608-627.

International Labour Organisation, Export Processing Zones (EPZs), http://www.ilo.org/actrav/areas/WCMS_DOC_ATR_ARE_EPZ_EN/lang--en/index.htm last accessed on 26 February 2013.

Sivaramakrishnan, K. C., Mukhopadhyay, Partha (2009) Special Economic Zones: Promise, Performance and Pending Issues. Working Paper, Centre for Policy Research, New Delhi. Available online: http://www.cprindia.org/moreworkingpapers.php?s=118

Website of the research project on "Politics of India's Special Economic Zones", coordinated by the Centre de Sciences Humaines and the Centre for Policy Research, New Delhi: http://www.indiasezpolitics.org

EADI
Kaiser-Friedrich-Strasse 11
D-53113 Bonn
Tel.: (+49) 228 . 2 61 81 01
info@chance2sustain.eu
www.eadi.org
www.chance2sustain.eu

Chance2Sustain examines how governments and citizens in cities with differing patterns of economic growth and socio-spatial inequality make use of participatory (or integrated) spatial knowledge management to direct urban governance towards more sustainable development.

Consortium partners: European Association of Development Research and Training Institutes (EADI, Germany), Governance for Inclusive Development (GID) at the Amsterdam Institute for Social Science Research (AISSR-UvA, Netherlands), Centre National de la Recherche Scientifique (CNRS, France), Centro Brasileiro de Análise e Planejamento (CEBRAP, Brazil), Cities for Life Forum (FORO, Peru), Norwegian Institute for Urban and Regional Research (NIBR, Norway), School of Planning and Architecture (SPA, India), University of KwaZulu-Natal (UKZN, South Africa)

Chance2Sustain Policy Brief
ISSN 2305-5960

SEVENTH FRAMEWORK PROGRAMME
Funded under Socio-economic Sciences & Humanities

EUROPEAN COMMISSION
European Research Area