

Draft

Discussion Paper to Facilitate
Stakeholder Consultation on Potential
Reform of the SEZ Policy and Operating
Framework

SEZ Division
Department of Commerce

Discussion Paper to Facilitate Stakeholder Consultation on Potential Reform of the SEZ Policy and Operating Framework

I. Background

The SEZ sector has grown significantly since the enactment of the SEZ Act 2005 and Rules in 2006, in terms of the number of SEZs, investment attracted, and employment and exports generated. While these achievements are irrefutable and significant, a comprehensive analytical assessment of the performance of the sector and certain key developments in the politico-economic environment in recent years reveals aspects of the SEZ Policy and Operational framework that perhaps require a re-look with a view to possible reform.

The objective of this paper is to identify these areas and throw up possible approaches to addressing them, with the objective of facilitating wider consultation with various stakeholders, before arriving at the future course of action to be adopted in an informed and transparent manner.

II. Salient Achievements of the SEZ Sector

The SEZ Act 2005 and the Rules were enacted with the following key objectives:-

- generation of additional economic activity
- promotion of exports of goods and services;
- promotion of investment from domestic and foreign sources;
- creation of employment opportunities;
- development of infrastructure facilities

Since 2006, in addition to the seven SEZs that preceded the SEZ Act 2005, a large number of SEZs have been established and many more are in the pipeline. As of 31st October 2011, 583 formal approvals have been granted for setting up SEZs, of which 381 have been notified and 143 are exporting. Their distribution across States and Sectors is described in Table 1 and Table 2, respectively:

Table 1: Distribution of SEZs across States

(As of 31st October 2011)

State	Formal Approval	Notified SEZs	Operational SEZs (Central Govt. + State Govt./Pvt. SEZs + notified SEZs under the Act, 2005)
Andhra Pradesh	109	75	36
Chandigarh	2	2	1
Chhattisgarh	2	1	0
Delhi	3	0	0
Dadra & Nagar Haveli	3	1	0
Goa	7	3	0
Gujarat	45	29	13
Haryana	46	35	3
Jharkhand	1	1	0
Karnataka	58	36	20
Kerala	28	20	7
Madhya Pradesh	15	6	1
Maharashtra	104	63	18
Nagaland	2	1	0
Orissa	10	6	1
Puducherry	1	0	0
Punjab	8	2	0
Rajasthan	10	9	4
Tamil Nadu	71	57	28
Uttar Pradesh	34	21	6
Uttarakhand	2	1	0
West Bengal	22	12	5
GRAND TOTAL	583	381	143

Table 2: Distribution of SEZs across Sectors

(As of 31st October 2011)

Sectors	Formal approvals	Notified SEZs	Operational SEZs (Central Govt. + State Govt./Pvt. SEZs + notified SEZs under the Act, 2005)
Agro	6	4	0
Airport based multiproduct	3	0	0
Auto and related	3	1	1
Aviation/Aerospace/ Animation & Gaming/ Copper	3	2	3
Beach & mineral/ metals	2	2	0
Bio-tech	33	19	2
Building prod./mal./ transport equit.	1	1	2
Electronic prod/ind	3	3	1
Engineering	21	16	8
Footwear/Leather	7	5	2
Food Processing	5	4	3
FTWZ	11	6	1
Gems and Jewellery	13	7	3
Handicrafts & Carpets	4	2	2
IT/ITES/Electronic Hardware/Semiconductor	354	236	80
Metal/Stain. Steel/Alum/Foundry	8	5	0
Light Engineering including Automotive/Automotive Components	1	0	1
Multi-Product	23	15	17
Multi-Services/Services	16	8	1
Non-Conventional Energy	6	5	2
Plastic processing	0	0	0
Petrochemicals & petro.	4	2	0
Pharma/chemicals	23	20	6
Port-based multi-product	8	2	2
Power/alternate energy/ solar	3	2	1
Textiles/Apparel/Wool	19	12	5
Writing and printing paper mills	2	1	0
Strategic Manufacturing	0	0	0
Granite processing Industries and other allied machinery/ manufacturing	1	1	0
GRAND TOTAL	583	381	143

Figure 1: Distribution of SEZs across States

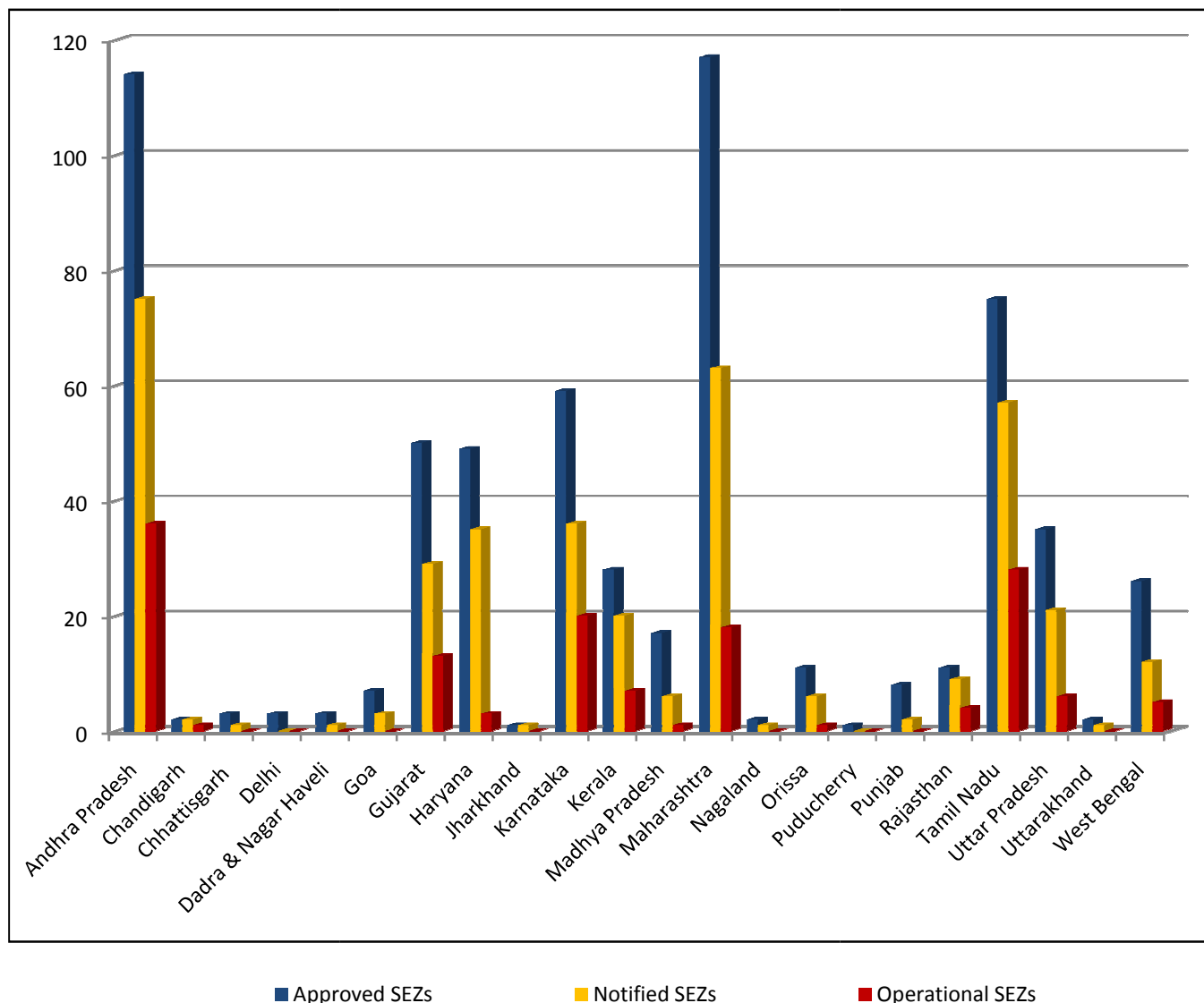


Figure 1

Investment and Employment: As of 30.06.2011, over Rs. 2,12,914.36 Crore has been invested in SEZs of which Rs. 2,08,878.85 Crore was invested after enactment of the new Act in 2006. As of 30.06.11 direct employment is being provided to 7,14,412 persons in SEZs of which 5,79,708 persons have been provided jobs subsequent to enactment of the SEZ Act 2005.

Exports: The Special Economic Zones are playing a vital role in enhancing Indian exports. During the financial year 2010-11, exports to the tune of Rs. 3,15,867.85 Crore have been made from the SEZs, registering a growth of about 43.11% over the exports for the year 2009-10. Exports during the first quarter of the current financial year i.e. up to 30.06.2011 have been to the tune of Rs. 72,255.49 Crore, a growth of about 23% over the corresponding period of the previous financial year. The export growth figures for the period 2006-07 to 2011-12 are given in Table 3.

Table 3: Exports from SEZs

Years	Physical Exports (Rs. Crore)	Growth Rate (year-to-year)
2006-2007	34,787	52%
2007-2008	66,638	93%
2008-2009	99,689	50%
2009-2010	2,20,712	121%
2010-2011	3,15,868	43.11%
2011-2012 (Apr-June)	72,255	23%

The Sector and State wise distribution of exports from SEZs in the year 2010-11 are given in Table 4 and 5, respectively.

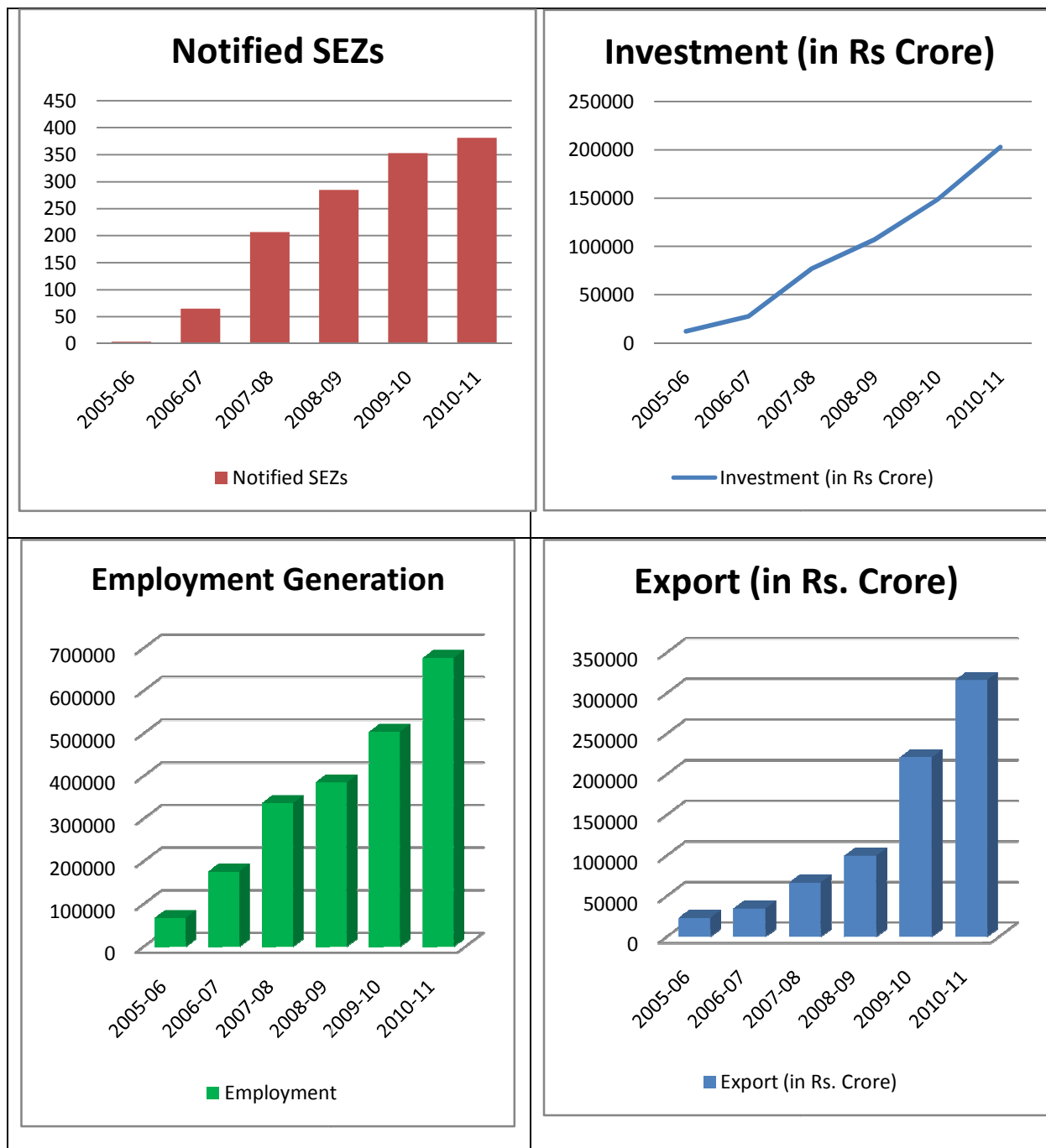
Table 4: Distribution of SEZ Exports across Sectors (for FY 2010-11)

S No.	Sector	Exports (Crores Rs.)
1	Biotech	465.51
2	Computer/ Electronic software	84699.89
3	Electronics hardware	21050.48
4	Electronics	1125.45
5	Engineering	2225.01
6	Gems and Jewellery	47848.50
7	Chem & Pharma(Crude Petroleum Refinery)	106558.27
8	Handicrafts	77.11
9	Plastic and rubber	1358.50
10	Leather, footwear and sports goods	425.62
11	Food and Agro Industry	620.68
12	Non-conventional and Solar Energy	1607.28
13	Trading and service	35866.80
14	Textiles and garments	2185.69
15	Misc.	9753.07
	Total	315867.85

Table 5: Distribution of SEZ Exports across States (for FY 2010-11)

Sl. No.	State	Exports (Crores Rs.)
1	Gujarat	146877.73
2	Karnataka	46717.99
3	Tamil Nadu	43704.60
4	Maharashtra	19480.05
5	Kerala	18750.65
6	Andhra Pradesh	13359.17
7	Uttar Pradesh	10703.17
8	West Bengal	10883.57
9	Haryana	2807.01
10	Madhya Pradesh	1242.65
11	Rajasthan	899.39
12	Chandigarh	318.00
13	Orissa	123.87
	TOTAL	315867.85

Figure 2: Growth of Notified SEZs and Trends in SEZ related Investment, Employment and Exports



The Imperative for Building on and Consolidating Initial Gains: While India's Balance of Payments situation has remained comfortable for quite some time now,

there are certain aspects of concern that need to be addressed before they assume serious proportions. In particular, India's Balance of Trade is in deficit, which is a fairly high proportion of GDP. Figure 3 below indicates that while exports have shown impressive growth over the past decade, imports have also risen sharply, resulting in a growing adverse balance of trade position. This gap is financed in part through net services income and net remittances. However, the Current Account remains in deficit, notwithstanding these inflows, and the remaining gap is covered through net inflows on the Capital Account. Given India's dependence on petroleum imports in very significant volume, its foreseeable import scenario would continue to put severe pressure on the Balance of Trade. The high proportion of very mobile and somewhat transient FII inflows on the Capital Account, adds to these concerns. Given this scenario there is no option for India other than promoting enhanced export and FDI growth. Given the very encouraging performance over the last five years, the SEZ program is a promising instrument for achieving both these objectives.

In light of these imperatives, Department of Commerce has evolved a strategy of doubling the country's merchandise exports by 2014 to US\$ 500 bn. and to US\$ 750 bn. by 2016-17.

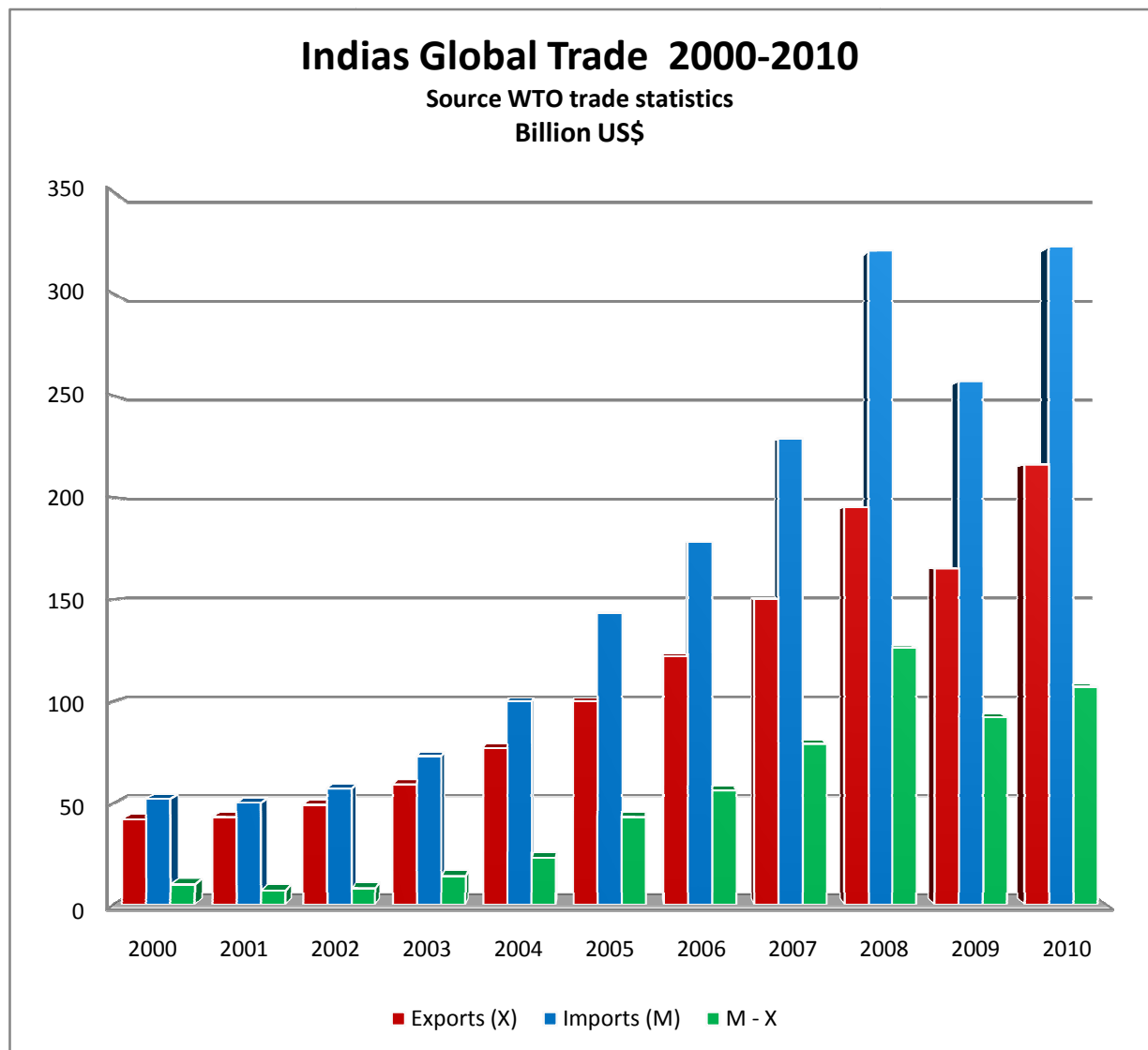
The strategy, inter alia, targets three areas for export promotion.

- (a) Provide incentives and make exports easier;
- (b) Help exporters get market access;
- (c) Improve export infrastructure

In this context the question which needs to be asked from the SEZ prospective is as to how SEZs can build upon their significant achievements and contribute towards

achieving the objective of doubling our exports by 2013-14. This paper examines the challenges in fulfilling this task at hand and identifies possible options for addressing them, with a view to enabling wider consultation.

Figure 3

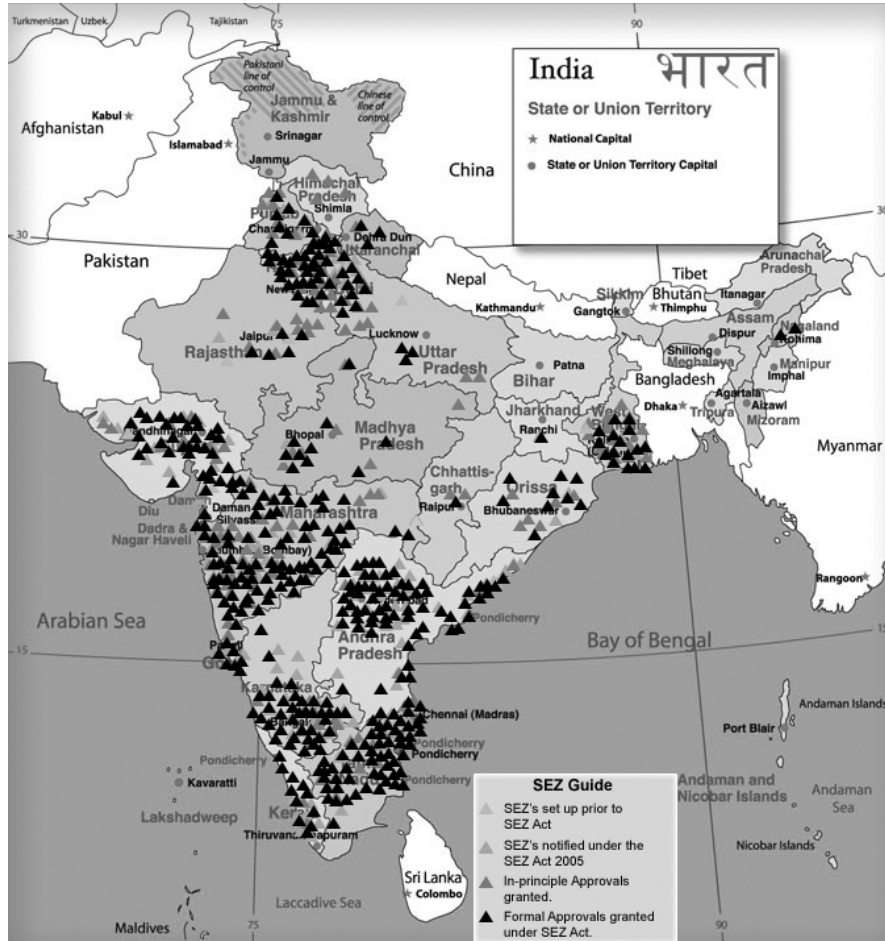


III. Some Significant Trends in SEZ Sector Growth:

An analytical assessment of the SEZ growth pattern since enactment of the SEZ Act 2005 reveals certain distinct trends, which perhaps are pointers to shortcomings in the conception and implementation of the SEZ policy framework. On a more constructive note they are also indicators of the opportunity that exists to build on the significant achievements of the sector through suitable reform. The key trends are as follows:

- 1. Geographical Concentration of SEZs:** Six States, Andhra Pradesh, Kerala, Maharashtra, Gujarat, Karnataka and Tamil Nadu, account for a major proportion of SEZs and 92% of total exports from them.
- 2. Urban centric growth of SEZs** – Even within these six States, SEZs are largely concentrated around existing urban agglomerates, leaving the hinterland virtually untouched.
- 3. Sectoral Dispersion of SEZs:** There is a pre-dominance of IT SEZs in the sector, and multi sector SEZs are few and far between. Of the 143 operational SEZs, only 17 are multi product SEZs.
- 4. Skewed Export Pattern:** IT/ITES SEZs and Petroleum sector contribute to the roughly two-thirds of SEZ exports. Non-petroleum manufacturing contributes the balance minority share.
- 5. Inadequate progress of Manufacturing activity:** As reflected in 3 and 4 above, the SEZ sector has not fully addressed the concern of boosting the manufacturing sector in India.
- 6. Limited number of Operational SEZs:** While 583 SEZs have been formally approved as on 31st Oct 2011, only 381 have been notified, of which only 143 SEZs are exporting i.e. only 24.53 % of the approved SEZs.

Figure 4: Distribution of SEZs in the Country



IV. Challenges facing the SEZs

A number of challenges, which can perhaps explain some of the adverse trends observed above, have emerged for the SEZ sector over the past six years. The most significant of these are:

- a) Issue of availability of primarily non-double cropped, contiguous and vacant land for SEZs and difficulties involved in procuring / acquiring land.
- b) Issue of maintaining attractiveness of the SEZ scheme in face of changed fiscal regime e.g. imposition of MAT/ DDT; possible changes through DTC.

- c) Issues related to effectiveness of the Single Window Mechanism and coordination across departments at the Central and State Government level.
- d) The issue of a large number of States not having an SEZ Policy / Act to enable provision of the benefits envisaged under the SEZ Act and Rules.
- e) Issue of constraints leading to slow pace of development of infrastructure within the SEZs and their operationalisation, as also inadequacies in the timely and adequate provision of external support infrastructure related to connectivity, provision of public utility services etc.
- f) Increasing unattractiveness of the SEZ incentive package vis-a-vis DTA units receiving benefits under schemes such as Focus Product Scheme, Focus Market Scheme, DPEB, Duty Drawback, VKGUY etc., which are unavailable to SEZ units.

V. Identifying and Addressing Perceptions

In addition to the above issues, SEZs have also had to contend with certain adverse perceptions that have tended to develop around them, often without adequate foundation or on account of a few black sheep, thereby causing damage to 'Brand SEZ' and thereby retarding progress which could have been achieved in this direction. Some of these perceptions are as follows:

Perception 1 - SEZs are only about garnering control of land – it is often alleged that many SEZ developers deviate from their declared purpose of setting up SEZs after taking possession of land. They do not set up the proposed SEZ and continue to hold on to large parcels of land with the intention of benefitting from its alternative usage and land price escalation.

Perception 2 - SEZs are tax havens leading to foregone duties and loss of government revenue: This conception has been perpetuated by the fact that SEZ Developers and Units are allowed duty concessions of various kinds under the SEZ Act. Often a blinkered view is taken with only duty forgone and fiscal benefits allowed being taken into consideration while ignoring other gains like enhanced exports, increased employment, increased investment etc. The fact that SEZ incentives are consistent with the general export promotion policies that apply to DTA units also, is ignored.

Perception 3 - Lack of co-ordination across Governmental Entities: Coordination issues between departments of the Central Government (DOR and MOEF etc.) and between the Centre and the State Governments, which undermine the objective of having a Single Window Mechanism; and

Perception 4 - Unstable fiscal policy environment: Significant shift in the promised fiscal incentives regime has led to uncertainty, caution and holding back on part of developers /units.

VI. Some Adverse Impacts Visible in the SEZ Sector

The emerging environmental challenges mentioned above have led to certain adverse impacts. Some of these are as follows:

- (i) Significant reduction in the number of proposals to set up SEZs;
- (ii) Withdrawal of significant number of proposals to set up SEZs at the in-principle / formal approval stage
- (iii) Significant increase in requests for de-notification of SEZs.
- (iv) Reduced interest in setting up Units in SEZs

VI. Possible approaches to addressing these challenges: Issues for Discussion

Based on feedback received from various stakeholders over time, including from recent interactions with the Principal Secretaries / Secretaries, Industry Department of various States and UTs, some possible approaches to the various issues requiring resolution are discussed below, to facilitate further consultation.

1. Issue of Land Availability for SEZs:

Clearly land availability for SEZs has become a constraint in the recent past, and the situation is accentuated by fairly onerous requirements of minimum size, contiguity, vacancy, pre-dominantly non-double cropped nature of land used for SEZs, non-compulsory acquisition / procurement etc. Notwithstanding possible exemption to SEZs built into it, the proposed Land Acquisition Act would possibly make the process of meeting the land requirement even more challenging.

These factors call for a review of all land related aspects of the SEZ policy so as to assess their underlying rationale and reasonableness. This would include aspects like minimum area criteria for SEZs, vacancy and contiguity norms, processing / non-processing Zone stipulations, permissible broad-banding within sectoral SEZs etc. This assessment would require adoption of a scientific basis that gives primacy to techno-economic considerations like scale of operations, work force strength and nature, nature of input and infrastructure requirements, nature of emissions / effluent treatment requirements of the units etc. The adopted approach would be required to balance the need to conserve and optimally use land with the requirements of economies of scale etc. It is for consideration as to how these objectives can be met while making alleviating to the extent possible the constraint of land availability.

Present Position: At present the land requirement for various classes of SEZs are as follows:

Table 6

TYPE	AREA	AREA FOR SPECIAL STATES/ UTs
Multi- product	1000 hectares	200 hectares
Multi services	100 hectares	100 hectares
Sector specific	100 hectares	50 hectares
Handicraft	10 hectares	10 hectares
IT	10 hectares & min. built up area as per SEZ rules.	10 hectares & min. built up area as per SEZ rules.
Gems and Jewellery	10 hectares & min. built up area as per SEZ rules.	10 hectares & min. built up area as per SEZ rules.
Bio-tech and Non-conventional energy (including solar energy equipments/cell but excluding SEZs for non-conventional energy production and manufacturing)	10 hectares & min. built up area as per SEZ rules.	10 hectares & min. built up area as per SEZ rules.
FTWZ	40 hectares & min. built up area as per SEZ rules.	40 hectares & min. built up area as per SEZ rules.

The Special States/UTs are Union Territories including the erstwhile Union Territory of Goa and the Special category States of Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Manipur, Tripura, Himachal Pradesh, Uttaranchal, Sikkim, Jammu & Kashmir.

With respect to the present ‘10-100-1000’ model the following implications / considerations are pertinent:

- a) There is a significant gap in the area requirements between the sector specific and multi sector SEZs i.e. 100 Ha and 1000 Ha, respectively.
- b) In the present context there is considerable difficulty in acquiring 1000 Ha of land meeting the criteria of contiguity, vacancy etc
- c) An objective assessment of the techno-economic requirements for commercial / industrial activity of the type envisaged under the SEZ policy indicates that to achieve economies of scale through clustering of a number of units of a similar nature, land to the extent of 1000 Ha may not be necessary. A large number of multi product SEZs like MSEZ, CSEZ, NSEZ etc., which pre-date the Act are below the 1000 Ha size.

Given these considerations, comments are invited on the optimal land requirements that could be specified for different categories of SEZs.

The following is a possible approach for consideration:

Table 7

TYPE	AREA	AREA FOR SPECIAL STATES/ UTs
Multi- product	250 hectares	100 hectares
Multi services	40 hectares	40 hectares
Sector specific SEZs or SEZs with limited specified* sectoral	40 hectares	25 hectares

broad-banding.		
IT, Handicrafts, Gems and Jewellery, Biotech and other similar specified* sectors or SEZs with specified limited broad-banding related to such sectors.	10 hectares & min. built up area as per SEZ rules.	10 hectares & min. built up area as per SEZ rules.

* Suggestions are invited to determine the sectors intended to be specified in this arrangement.

2. Contiguity Norms:

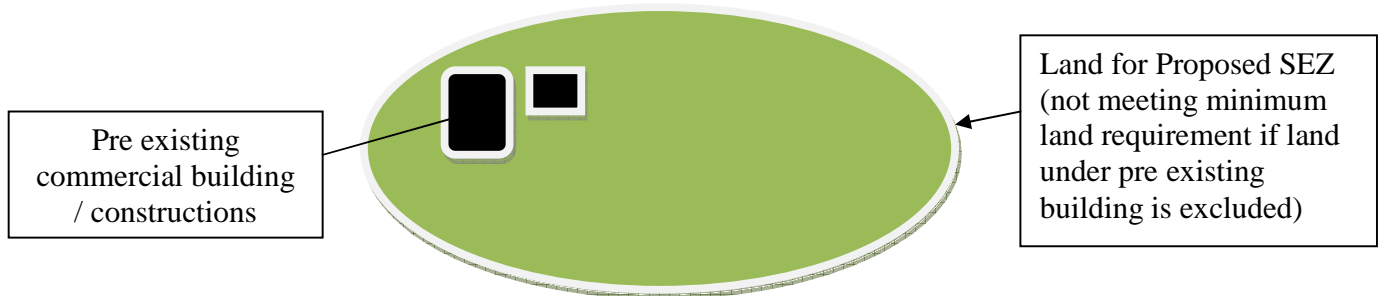
The issue of contiguity impacts the degree of difficulty involved in fulfilling the land needs of SEZs and needs to be addressed as part of the land policy for SEZs. The SEZ Act allows the BoA to relax the contiguity norms wherever necessary. In many instances the parcels of land are dissected by national highways, state highways, rail links, natural water bodies etc. In order to maintain contiguity, over-bridges, under-passes, sky-walks, flyovers etc. have been required, which lead to an increase in the project cost without serving any essential productive purpose. The underlying rationale for contiguity is related to the requirement of ring fencing physical areas as bonded zones where activities involving duty concessions of various kinds are undertaken. The recognized distinction between processing and non-processing zones and advances in technology can possibly be used to devise mechanisms to achieve the regulatory objective through alternative means, which allow more flexibility in contiguity norms. Some suggestions are as follows:

- Contiguity norms could be applied strictly to the processing area where the core activity of the SEZ takes place and with some flexibility to the non-processing areas. The exact norms that satisfy the minimum regulatory requirements would need to be identified.
- IT SEZs need not have the same nature of physical fencing etc, as required for a manufacturing SEZ. If a somewhat relaxed system of physical checks / fencing are sufficient for ensuring compliance with SEZ norms then these may be identified and adopted.
- More entry/exit gates manned by SEZ personnel may be provided so as to address regulatory concerns arising from lack of physical contiguity due to National / State highways, rail lines, natural water bodies, unavailable land parcels etc. As personnel at such gates are deployed on cost-recovery basis and the cost is borne by the developer, this option could be made available to developers.

3. Vacancy Issues:

The definition of vacant land was liberalized to an extent by introducing clause 2(z)(f) under the SEZ Rules where it has been provided that notwithstanding existing structures, the land in question would be considered vacant if these structures / buildings have not been put to commercial use. It is for consideration whether this can possibly be further extended to include parcels of land on which certain commercial buildings already exist with suitable safeguards and restrictions on benefits etc. This could address a situation where if a land parcel is unable to meet the minimum criteria of vacant, contiguous land of the prescribed size owing to a part of the land parcel having certain operational building / structures on it, the remaining land parcel also becomes unavailable for utilization under any future SEZ project. (see Figure 5)

Figure 5: Diagrammatical Representation of pre-existing buildings / structures in a proposed SEZ site



In such cases the following norms could be considered:

- i. The land under pre-existing buildings/structures being used for commercial purposes would not exceed 20 % of the over all SEZ land parcel for the proposed SEZ.
- ii. Pre-existing operational buildings/structures on a land parcel would be delineated and would not be entitled to any duty concessions on the pre existing structures.
- iii. New construction in the SEZ would be accorded the benefits of fiscal concessions as per the SEZ Policy.
- iv. Additional investment (not O&M) made on the existing buildings would become eligible for fiscal incentives just like new construction in the SEZ
- v. The pre-existing buildings/structures would be required to comply with the SEZ norms after notification.
- vi. These provisions can be resorted to only to meet the marginal land requirement to meet the minimum land criteria.

The above liberalization on the issue of vacancy and contiguity coupled with the reduced minimum area criteria for land would enable many developers to meet the land criteria of SEZs with greater ease and enable quicker operationalisation of SEZ projects in significant numbers.

4. The Issue of Broad-banding

A significant aspect of the SEZ policy is to encourage clustering of similar units so as to tap into the economies of scale in creating and operating common facilities and generating external economies of scale that lower costs for the concentrated industry as a whole. While multi-sector SEZs are expected to achieve these objectives through the large scale of their operations involving a large number of units, 'Sector Specific' SEZs were introduced in the policy to achieve this objective through creation of a significantly sized cluster of similar enterprises. However, there have been objections from the industry that such narrow sector specification has led to an unreasonable restriction on the kind of units permissible in these SEZs, thereby making it difficult in many instances for them to attract sufficient units to optimally utilize the available land and other manufacturing infrastructure. It is felt that similarity of units required to achieve the economies envisaged in the clustering approach can be achieved even through inclusion of a larger number of sectors that have similar characteristics in terms of nature and size of the workforce, infrastructure requirements for operation and effluent treatment etc. In these circumstances, there is a case for:

- a) Allowing a broader category of types of units that can be set up in a sector specific SEZ or
- b) Perhaps not prescribing any specific sectors for SEZs but prescribe negative sector lists for SEZs of smaller dimensions, which would need to be specified.

5. Non processing zones – a relook

At present the SEZ is divided into processing and non processing zones, with the main economic activity directly involving production of goods and services taking place in the processing zone, and the non processing zone being used for creation of support infrastructure. This was envisaged to ensure that existing social and other infrastructure in urban centres was not placed under undue pressure due to increased economic activity on account of emerging SEZs, as also to ensure that where the SEZ came up in an underdeveloped backward region, such infrastructure could be created in the non-processing zone. The SEZs, especially the larger multi sector SEZs, were encouraged to become independent self contained townships. The six year SEZ experience has shown that this has clearly not been achieved so far. In practice it has been seen that such infrastructure, while essential for the SEZ, is often not viable due to low capacity utilization or in-optimal scale of operation when DTA entities are not allowed to be served by it. While restrictions on allowing development of support infrastructure like housing, schools, hospitals, vocational institutes, hotels etc. in non-processing zones of SEZs on grounds of not being adequately focused on serving SEZ needs have at times been found unreasonable and impractical by developers, the policy maker has been constrained in exercising discretion by the absence of clear norms and guidelines.

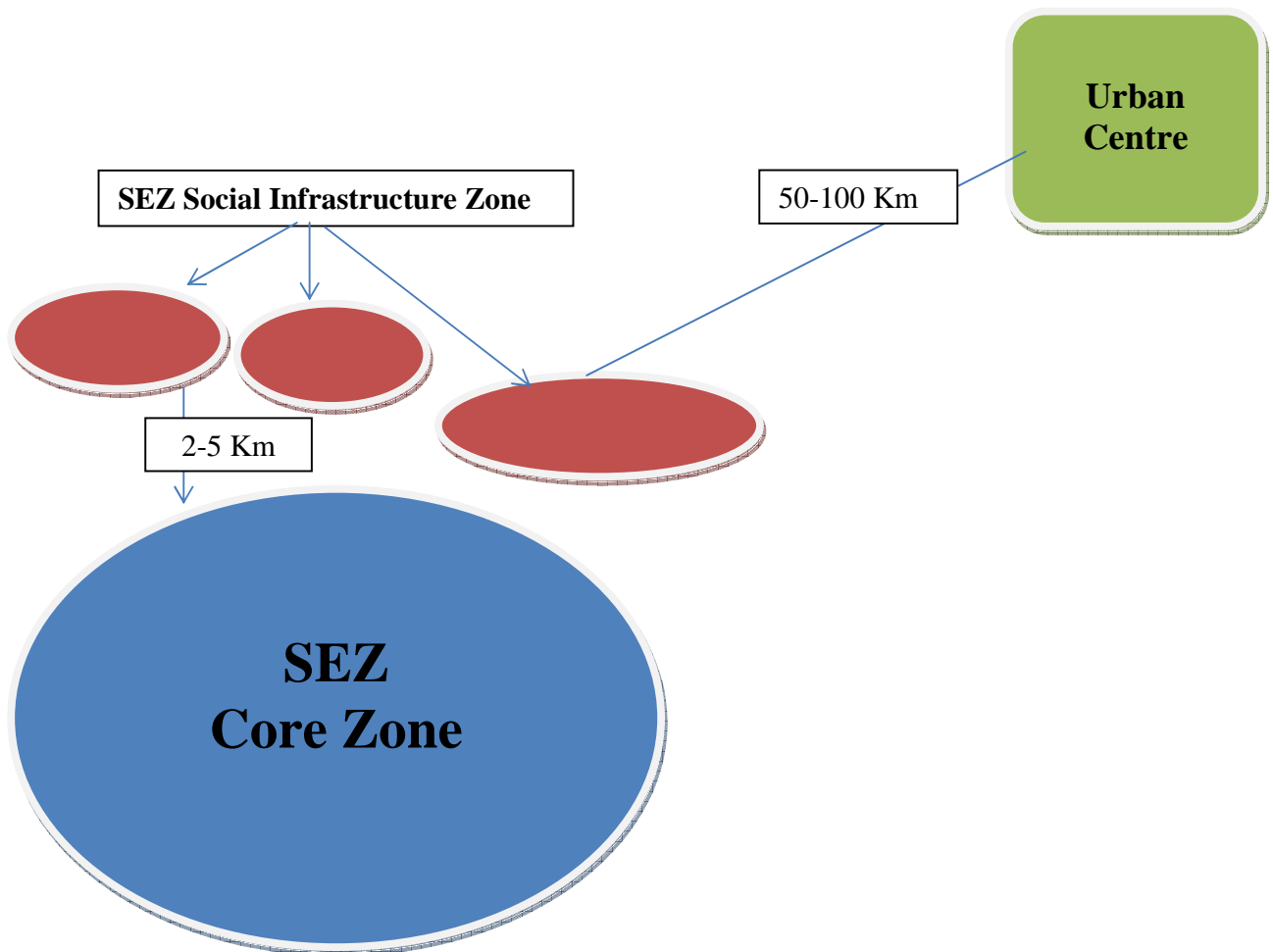
The following approaches could be considered to balance the need for availability of such infrastructure for SEZs, especially where it does not exist in a proximate urban agglomerate, with the need to ensure that duty benefits and concessions are not allowed for activities that are not adequately linked to serving the SEZ:

- (i) SEZs coming up in the vicinity, say within 50-100 KMs, of a major urban centre (to be defined for each State) with adequate social infrastructure for

the SEZ's needs, could be disallowed such social infrastructure, except with a reasonable area restriction as a proportion of the overall size of the non-processing zone, with permission to serve DTA clients with surplus capacity available after serving SEZ needs, but without any duty / other concessions on this infrastructure.

- (ii) When the SEZ is developed beyond this 50-100 KM range, developers / co-developers could be allowed such social infrastructure with a reasonable area restriction as a proportion of the overall size of the non-processing zone, with permission to serve DTA clients with surplus capacity available after serving SEZ needs, and with duty / other concessions allowed to developers / co-developers on the creation of such non-processing zone infrastructure, which would be subject to the processing zone becoming operational (*to be defined*) within a reasonable timeframe. This would create incentives for dispersal of economic activity to backward areas.
- (iii) Alternatively, (i) and (ii) could be allowed with the modification that duty concessions are not available in either case for such social infrastructure. In both instances, however, the area norms for setting up social infrastructure could be more liberal for the SEZs set up away from the developed urban centres.
- (iv) A variant, which makes a social infrastructure zone mandatory for an SEZ in a backward area, either in the non-processing area with maximum area stipulations or in the vicinity of the SEZ (see Figure 6), could be considered.

Figure 6: Diagrammatical Representation of SEZ (Core Zone and Social Infrastructure Zone)



VII. Greater involvement of State Governments

State Governments are important stake holders in the implementation of the SEZ policy. Transparent and effective implementation of the policy can enable States/UTs to gain significantly by way of increased investment, employment and overall development. To achieve this, States / UTs are required to provide enabling inputs like making available exemption from state levies and taxes, ensure effective single window mechanism by delegating powers to SEZ officials,

providing connectivity and access to utility services etc. The six year experience has shown that while the SEZ Act contains provisions that give it an overriding effect over inconsistent provisions in other legislations, this has not translated at the ground level into fulfillment of State Government obligations and an effective single window mechanism at the State level. Developers often complain that many State Governments do not follow the SEZ Act in letter and spirit, thereby denying them crucial benefits at the ground level. Effective steps in this regard can reduce the inter-state disparities in the success of the SEZ program, and enable less developed States to catch up. Some crucial issues which need to be addressed by States include the following:

1. SEZ Acts and Rules of States:

Sub-Rule (3) of Rule 5 of SEZ Rules 2006 envisages certain facilities like exemption from State / local taxes, levies and duties, eternal connectivity, provision of water, electricity etc., which State Governments need to endeavor to fulfill. There is need for an enabling legal framework at the State level to provide these facilities. Hence enactment of a State level SEZ Act & Rules is important. As on date, some States like Gujarat, Haryana, Madhya Pradesh, West Bengal, Tamil Nadu etc. have come up with their own SEZ Act and Rules. Other States also need to make adequate provisions in this regard.

2. Empowered Committee: Single Window Clearance:

State Governments are required to create an Empowered Committee for granting various State Government approvals through a Single Window Mechanism to SEZ Developers. A formulation in this regard was circulated to all the State

Governments and Union Territories in January 2008. Some States like Gujarat, Haryana, West Bengal, Madhya Pradesh, Uttar Pradesh, Tamil Nadu etc. have put such mechanisms in place.

3. External Connectivity for SEZs:

External connectivity and provision of utility services are of vital importance for an SEZ. Connectivity issues range from connectivity with the major rail / road arteries, extension of the Mass Rapid Transit System (MRTS) to the SEZ, rail connectivity to dry ports, establishment of cargo airports etc. State Government must take adequate steps to provide connectivity and public utility services such as water, drainage connections etc. for the SEZs.

4. Exemption from the State & local taxes, levies and duties including stamp duty and taxes levied by local bodies:

Many State Governments are still to issue notifications for exemption of State and local taxes. In some States a policy exists, but in the absence of notifications, benefits are not being allowed. In some States, while developers are being allowed these concessions, co-developers and units are not being allowed.

5. Exemption from local body jurisdictions:

Article 243 Q of the Indian Constitution provides for the creation of Industrial Township Authorities to manage the affairs of Industrial Townships. Gujarat SEZ Act, under Section 11 Sub section (2) states that the SEZ shall cease to be under the jurisdiction of any municipal council / corporation / notified area / panchayat. Thus,

in order to avoid duplication of functions, SEZs should be excluded from the jurisdiction of the Municipal Corporation, especially in aspects like Open Space Reserve (OSR) requirements or payment of taxes etc.

VIII. Encouraging Manufacturing Sector Units in SEZs: Can we leverage India's Domestic Market?

A major advantage India has over other competing countries (Malaysia, Philippines, Vietnam etc.) is its huge and growing domestic market. Investors would potentially be eager to access this market. SEZ policy at present seeks to invite FDI for setting up SEZs with export obligations, with restricted access to the domestic market. Accessing the DTA is cumbersome in many cases. There are examples of Dell Computers, Nokia etc. targeting the Indian market through special provisions like the ITA etc.

Leveraging the attractiveness of DTA sales for manufacturers could yield better dividends. A ready model available for this is the EOU Scheme. DTA sale entitlements could specifically be considered to attract FDI in the Manufacturing Sector. A DTA sale entitlement on concessional duty to the extent of say 50% of the total Exports made by a Unit, after it has achieved NFE positive status could be considered.

IX. Allowing SEZs Units to compete in an FTA Regime

India has entered into a large number of regional, bilateral, plurilateral and multilateral arrangements with many countries (e.g. FTA etc). In many cases products originating from our FTA partner countries are allowed major duty concessions (if not nil duty) on import into India. In such a scenario if a unit in an

SEZ were to sell a competing product into DTA it would be adversely placed vis a vis the product from a FTA partner country as the SEZ unit does not enjoy the duty concession as provided by FTA. The result of this position is that manufacturers keen to exploit the Indian market are better placed if they set up their manufacturing units in India's FTA partner countries and then export those products to Indian market. Even Indian manufacturers are tempted to set up shop in overseas FTA partner countries to sell their products into Indian market. As a result India loses the investment, employment and technological up-gradation advantages which could come by way of attracting large manufacturers to setup base on Indian soil.

To address this anomaly it is proposed that SEZ units should be accorded the most favoured treatment in terms of duty concessions etc for the different products accorded under any regional, bilateral, plurilateral or multilateral arrangements entered into by India. e.g if India allows mobile phones manufactured in its RTA partner country 'A' to be imported into India at 5% duty and allows another FTA partner country 'B' to export the same product to India at 'Nil' duty, then a manufacturer who sets up a manufacturing unit in a SEZ to manufacture similar mobile phones should be allowed to sell such phones to DTA at 'Nil' duty (most favoured treatment).

X. Allowing SEZs to be DTA Units Plus

SEZs have an obligation to meet export targets to be NFE positive. To create a level, distortion free environment, SEZ entities should get broadly similar quantum of incentives as being provided to exporters in the DTA. Liberalization of the tax regime, coupled with stagnant or shrinking fiscal incentives for SEZs has resulted

in the SEZ units losing their competitive edge and in many cases being at a disadvantage vis-à-vis their DTA counterparts. This is particularly true in light of imposition of MAT and DDT and the impending DTC. Denial of export benefits like DPEB, duty drawback, focused product and focused market scheme and VGKYU etc to the SEZ units, which are available in a certain quantum to DTA units, have put the SEZ units at a disadvantage in many cases. Lower interest in setting up Units would result in an adverse impact on the incentives for developers to set up SEZs.

This needs to be addressed urgently by way of suitable rationalization for which suggestions are invited.

XI. Issue of Streamlining Operational Procedures and Processes

Processes and procedures for approvals, reporting etc. to operationalize the policy should be extremely user friendly, so as to uphold the underlying regulatory objectives, without imposing high transactions costs on SEZ entities in complying with them. This would involve aspects like use of e-governance innovations etc. Suggestions are invited from stakeholders on this aspect also.

XII. Summary of Issues for Stakeholder Feedback

In the context given above comprehensive, actionable responses are requested from stakeholders by way of suggestions for possible reform of the SEZ framework, in particular on the issues described above. Some of the key questions that require resolution are:

1. What are the reasons for lack of spread of SEZs to States other than a select few? How can they be addressed? How can SEZ investments be attracted in backward regions within the States?
2. What are the constraints coming in the way of greater manufacturing investments under the SEZ scheme and how can we overcome them?
3. What are the reasons for lack of operationalisation of many approved SEZs? How can we overcome these problems and what are the incentives and disincentives that can be created towards this end?
4. What are the categories of SEZs that should ideally be envisaged? What should be the minimum area requirements in each case and what should be the sectoral broadbanding permissible in each case?
5. How can contiguity norms / practices be revised to facilitate easier fulfillment of land requirements without compromising regulatory concerns?
6. How can vacancy norms be revised to facilitate easier fulfillment of land requirements without compromising the requirement that SEZs should not result in diversion of existing investments from DTA areas?
7. What should be the norms for permitting social/other infrastructure for dual SEZ / DTA use to balance the considerations of availability of quality infrastructure for SEZ use, viable scale / operation and avoidance of grant of undue benefits for non SEZ purposes?

8. How can broad parity be maintained in the quantum of benefits permissible to SEZ units vis a vis non-SEZ exporters? What specific adjustments can be considered?
9. How can better coordination be ensured between the Centre and the State Governments to ensure that elements of SEZ framework related to State level benefits and infrastructure provision etc. are smoothly implemented?
10. How can the SEZ framework attract FDI and other investment by leveraging the large domestic market, within the SEZ framework?
11. How can various specific operating procedures and processes related to approvals, reporting requirements etc. be simplified and made more transparent and user friendly? (Specific suggestions may be made)