

# *In the Name of Growth*

## THE POLITICS AND ECONOMICS OF INDIA'S SPECIAL ECONOMIC ZONES

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## TABLE OF CONTENTS

INTRODUCTION.....	1
Structure of the Study.....	2
<hr/> <b>PART I: BACKGROUND AND HISTORICAL EXPERIENCES</b> <hr/>	
CHAPTER I: CONCEPTUAL FOUNDATIONS .....	4
Foreign Investment and Export Promotion.....	4
The Use of Zones.....	10
Conclusion.....	12
CHAPTER II: EXPORT PROCESSING ZONES AND SPECIAL ECONOMIC ZONES AROUND THE WORLD.....	14
The Economic Impact of EPZ's.....	14
Zones As Political Institutions.....	20
Some EPZ 'Success Stories' and Their Politics.....	24
Conclusion.....	26
CHAPTER III: THE CHINESE EXPERIENCE.....	27
Background and History.....	27
Economic Aspects.....	30
Wider Consequences.....	32
Responses and Reactions.....	37
CHAPTER IV: ZONES IN INDIA.....	39
A History of India's EPZ's.....	39
The Politics of Policy and the Success of EPZ's.....	44
Institutions in Indian Zones.....	47
Conclusions.....	50
A Summary Of Experiences.....	51
<hr/> <b>PART II: THE SEZ ACT AND THE FUTURE</b> <hr/>	
CHAPTER V: THE SEZ ACT AND RULES.....	53
Applying For and Declaring Special Economic Zones.....	53
Operations in SEZ's.....	57
Tax and Customs Concessions.....	59
Regulatory Arrangements and Relaxations.....	62
Labour Laws.....	63
Institutions and Government.....	64
Conclusion.....	66
CHAPTER VI: LIKELY ECONOMIC IMPACTS OF SEZ'S.....	69
Investment in SEZ's.....	69
Tendencies in Sectoral Composition of SEZ Investment.....	70
Exports from SEZ's.....	78
Multi Product SEZ's.....	79

Employment.....	82
Large Revenue Losses and Wider Effects.....	84
Conclusion .....	86
CHAPTER VII: THE POLITICAL STRUGGLE AROUND SPECIAL ECONOMIC ZONES.....	87
The Actors in the Conflict.....	87
Issues of Conflict.....	91
Current Events.....	99
SEZ's and Democracy.....	100
CONCLUSION .....	102
BIBLIOGRAPHY .....	105

Few topics have attracted as much political, press and popular attention in the last year as Special Economic Zones. SEZ's and their consequences have triggered mass demonstrations, police firings, general strikes and Parliamentary showdowns, making them one of the most politically explosive initiatives of the UPA government. No other economic 'reform' of recent years has triggered this kind of conflagration.

Yet this is hardly surprising, for SEZ's are not just one more economic policy. They aim to do nothing less than reverse the claimed shortcomings of fifteen years of liberalisation in this country, namely low manufactured exports, 'jobless growth' and the failure to improve infrastructure. By changing patterns of both foreign and domestic investment in India, proponents of SEZ's claim they will create new islands of infrastructure and export promotion, all the while generating lakhs of jobs. SEZ's will be the driving force towards a new era of high growth, a new formula for solving the 'gaps' in economic reforms. How would SEZ's achieve this goal? By marrying economic incentives, new investment and new systems of governance – in short, creating a new economic, geographical and *political* reality.

It is precisely this that makes SEZ's so explosive. Any effort at understanding Special Economic Zones forces us to acknowledge that all economic measures are also political measures. The struggle over Special Economic Zones is not merely one of “growth” versus “displacement”, but over who will wield control over resources, finance and political power, and the institutions that will shape that control. In vain do financial analysts and government officials claim that SEZ's are “just another export promotion scheme”; in vain does the English press complain that 'sectional' interests and “anti-development” activists are holding up India's future. By now, SEZ's are far bigger than such slogans. They have become the flashpoints in a conflict that is increasingly about the vision for the future of India's economy, and by extension its society and polity.

This study approaches Special Economic Zones with this point as its fundamental premise. I attempt to explore Special Economic Zones as economic policy measures occurring within a political context. The assumption is that such an exploration cannot remain limited either to the narrow perspective of export performance and investment figures, *or* to the critique of SEZ's as a corporate land grab. To really understand SEZ's, we have to look at them from both these points of view, and

more.

It is only within such a broader perspective that SEZ's can be judged in a holistic fashion. And it is significant that what emerges, at least in the assessment of this study, is that SEZ's will be a political, economic and social disaster, likely to fail to produce any of their expected gains and to result in conflicts and ripple effects that will impact Indian society as a whole.

### ***Structure of the Study***

This study is divided into two parts and seven chapters. Part I is an examination of the background and history of Special Economic Zones and their predecessors, the Export Processing Zones. Chapter 1 describes the theoretical foundations of debates around SEZ's / EPZ's and outlines the conceptual framework that will be used in this study. Chapter 2 examines the experience of zones in other parts of the world, while Chapter 3 focuses on the example that seems to overshadow all Indian debates on SEZ's – China. Chapter 4 then briefly explores the history and experience of India's own EPZ and SEZ policies. Each of these chapters looks both at traditional economic measures such as investment, exports and employment and at wider sociopolitical issues. Part I ends with a summary of three main points that emerge from these experiences.

Part II turns to the current SEZ policy. Chapter 5 describes in depth the SEZ Act and related legislative and policy measures. Chapter 6 then analyses the implementation of the policy so far and outlines the likely economic impacts of SEZ's in India. Chapter 7 explores the political dimension of the controversy around SEZ's and its various aspects.

The Conclusion, finally, discusses some possible alternative scenarios and the likely future impacts of SEZ's in India.

*It should be noted that this study comes at a time of rapid policy changes, and hence some of the details of the policy cited here may cease to be correct in the event of such change. However, the arguments in this study are unlikely to be affected by the changes expected in the near future.*

*In particular, as this study was being completed, the Empowered Group of Ministers submitted its recommendations on the SEZ policy. Recommendations that were reported in the press are referred to in footnotes in chapters 5 and 6 and described in chapter 7.*

*PART I: BACKGROUND AND  
HISTORICAL EXPERIENCES*

## CHAPTER I: CONCEPTUAL FOUNDATIONS

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Much of the press debate in India makes the error of identifying Special Economic Zones as a new phenomenon, and in particular equating them with the Chinese experience. In reality, Special Economic Zones are a special case of the better known policy of Export Processing Zones. EPZ's are neither new – the concept is many decades old – nor limited to China and East Asia; indeed they have spread across the entire world.

EPZ's have certain basic shared features in almost all the countries that have tried to implement them. The International Labour Organisation (1998) defined Export Processing Zones as “industrial zones with special incentives to attract foreign investment in which imported materials undergo some degree of processing before being exported again.” A more detailed characterisation is given by Jayanthakumaran (2003):

- EPZ's consist of an 'enclave' dedicated to the promotion of export processing and isolated from the domestic economy;
- Within these areas, state controls over industry are relaxed and bureaucratic procedures simplified;
- Foreign (and often domestic) investors in zones are given favoured treatment with respect to taxation, import controls, infrastructure and, in some cases, labour laws;
- In return, “investors are expected to process all intermediate imports within the zone and to export without adversely affecting the domestic economy.”

The similarity with Indian SEZ's is immediately clear. To understand the concept of an SEZ, therefore, we have first to explore the theoretical foundations of EPZ's themselves.

### ***Foreign Investment and Export Promotion***

Why should a country decide to create Export Processing Zones? Justifications have varied over time and place, but there are two basic conceptual premises for an EPZ policy:

1. That there is a need for special incentives, policies and systems in order to 1) attract foreign

investment into, and 2) promote exports from, the industrial and manufacturing sector within a country;

2. That these initiatives either cannot or should not be extended beyond a specified geographical area, namely a “zone.”

There is a tendency in India today to treat the first premise as self-evident, with the policy debate focusing on the second. Yet the first premise is not as straightforward as it seems. There are long-running critiques of the use of incentives in this fashion. A brief exploration of some of these critiques give us a starting point to gauging India's SEZ policy and understanding its likely impacts.

### *Using Incentives to Attract Foreign Investment*

The starting premise for most policymakers interested in export protection zones is that there are too many barriers to investment in the wider economy of the country. These barriers are held to be deterring foreign investors from investing. Therefore, foreign investors have to be compensated through suitable incentives and schemes if the level of investment in the country is to be increased.

But why such a need for foreign investment? The three most commonly cited reasons are as follows. First, it is believed that there is insufficient savings or capital within a country to invest in new projects. Second, as a spin off of the first, foreign investment is seen as a potential tool to increase employment in manufacturing, especially in predominantly agrarian countries. Finally, technology transfer and other forms of “learning” from foreign companies are believed to benefit domestic companies<sup>1</sup>. Indeed, Ge (1999) builds an entire model of the benefits of EPZ's on the basis of technology transfer alone, albeit on the basis of somewhat unlikely assumptions<sup>2</sup>.

These positions became the common sense of economic policy across much of the developing world throughout the 1960's and 1970's, leading to growing competition between developing nations to attract foreign direct investment (FDI)<sup>3</sup>. Yet, even as this competition grew, critiques of this strategy also grew. The most fundamental is what is commonly called the “race to the bottom” argument – that

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<sup>1</sup> See for instance Jayanthakumaran 2003.

<sup>2</sup> Including that technology transfer occurs regardless of the desire of the foreign investor, that transfer is directly and linearly proportional to production in the EPZ, and that this technology transfer has a direct relationship with the export performance of the country.

<sup>3</sup> FDI should be distinguished from foreign institutional investment, or FII. The former is investment of capital in the form of either 'greenfield' projects (i.e new projects) or in the purchase of large amounts of shares in existing companies. The latter is portfolio investment, namely purchases of small numbers of shares on the stock market, investment in bank accounts or debt instruments and so on. FDI is generally regarded as less unstable and volatile than FII.



where the primary attraction for foreign investment is a relative advantage (not, to be noted, a comparative advantage in the classical sense) in the form of incentives and cheap labour, this only leads to ever growing reductions in taxation and efforts to depress wages. The resulting “race to the bottom” has dangerous effects on the abilities of countries to regulate their economies and ensure the welfare and rights of their people, particularly workers<sup>4</sup>. The race typically leads to tax cuts and benefits even when such incentives exceed the socially optimal level and lead to net losses to the economy; Oxfam (2000) estimates that developing nations currently lose 50 billion dollars per year to tax exemptions. The political power that foreign investors come to yield in a polity driven by the desire to draw foreign investment exacerbates such problems and makes it impossible to withdraw or reduce incentives. The concern in India regarding revenue losses from SEZs is thus hardly misplaced.

Further, the effectiveness of such incentive policies has often come into question. The literature on EPZ's, particularly by proponents, largely assumes that the decisions of foreign investors on an investment location are based mostly on the domestic policies of the government concerned. But the issue is significantly more complex than this. Shah (2005) finds that the size of the domestic market, the rate of growth, political and macroeconomic stability, and access to raw materials – all issues that cannot be affected by incentive policies – rate at least as important as “policy postures” when multinational investors are choosing locations. As the United Nations Conference on Trade and Development (2003) puts it, “It is generally accepted that location incentives are seldom the main determinant of location decisions by TNCs.”

The other side of this reality is that incentives have a crucial effect on the *kind* of investment that is attracted. The effectiveness of incentives varies from sector to sector of industry, depending on how much importance that particular industry places upon the factors that can be affected by incentives. The more important fixed factors such as raw materials or market size are, the less important incentives will be. For instance, the steel industry is unlikely to find incentives as important as access to iron ore and easy access to transport. On the other hand, the garments industry would give considerable importance to incentives, as its products are easily transportable and depend on widely available raw materials, while its costs depend heavily on wages and taxes.

Studies on EPZ's have thus argued that industries attracted by EPZ incentives and similar schemes will tend to fall into one of the following categories:

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<sup>4</sup> See for instance Jauch 2002.

- Light forms of “footloose” manufacturing, such as electronics and textiles, which do not depend on particular locations and are easy to move<sup>5</sup>;
- Industries that for other reasons have a desire to disperse production and do not incur significant costs in doing so, such as garments companies seeking access to quotas under the now-defunct Multi Fibre Agreement<sup>6</sup>;
- Other sectors reliant primarily on cheap and unskilled labour<sup>7</sup>.

In short, industries locating in EPZ's would tend to be *shorter term, more volatile*, and more reliant on *low wage, low-skilled labour*. As we shall see in the next chapter, the empirical data on EPZ's tends to bear out this theoretical prediction.

This in turn has an effect on whether or not the FDI generated will achieve the other benefits that are expected from it, particularly technology transfer and employment, since investors lack a long term interest in the area. The tendency to keep capital and knowledge intensive activities, especially R&D, in the home country of the investor remains strong. If it does occur, technology transfer tends to be in the form of skills imparted to workers, which again is less likely in the case of labour-intensive activities and unskilled work; the skilled and managerial workforce may simply be brought in from abroad. The net result is that, contrary to the assumptions made by many supporters of EPZ's, the potential for technology transfer remains low, with such transfer being the exception rather than the rule<sup>8</sup>. With regard to employment, while large numbers of jobs may be created, employment will tend to be insecure and with a high turnover as skill levels are unimportant. Once again, empirical data bears out this prediction.

Moreover, proponents of SEZ's in India have a tendency to quote all of the above reasons given for foreign investment – but then to confuse the issue of attracting foreign investment with the issue of attracting private sector investment in general. This results in a serious conceptual problem, for the critiques noted above apply with redoubled force when domestic private sector investment is at stake. Providing incentives results in a natural tendency to attempt relocation of existing industries into incentive zones, one of the biggest fears expressed about SEZ's in India. Moreover, it has a tendency to distort private sector investment in general in favour of the tendencies noted above.

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<sup>5</sup> Jayanthakumaran 2003.

<sup>6</sup> *Ibid.*

<sup>7</sup> Amirahmadi 1995, UNCTAD 2003.

<sup>8</sup> Amirahmadi 1995.

The use of incentives in EPZ's and similar schemes is thus not as simple as it seems. Incentives may or may not work; they may only work at the cost of larger social goals; and when they do work, they shape investment in a manner that is not necessarily socially or economically desirable.

### *Incentives for the Promotion of Exports*

The second major rationale for EPZ's is the encouragement of exports. Even before export orientation began to be seen as an inherently good policy, export promotion became important to countries in need of foreign exchange to import capital goods, machinery, fuels and so on. High tariffs and protection for domestic industry, as was the case in most of the developing world during the import substitution period following the Second World War, drove up prices and reduced quality, making it difficult for domestic industries to export. The lack of technology and lack of integration with international markets also may make exporting difficult in the absence of foreign investment. But FDI in a context of high levels of protection had a tendency to concentrate on protected capital intensive industries in order to take advantage of high domestic prices and evade tariff costs<sup>9</sup>. Therefore, developing countries could not take advantage of their major attraction for foreign investors, namely cheap labour.

Tax breaks, infrastructural services and other incentives linked to exports thus became a feature of many developing countries' policies. EPZ's tended to be the most sweeping of such schemes. The relaxation of tariffs and duties for EPZ's further drew foreign investors interested in outsourcing production on the basis of lower labour costs, while also allowing domestic investors in EPZ's to have cheaper access to imported raw materials for exports. This pattern continued as export orientation became considered increasingly for economic growth in general.

In a similar pattern to the drive for foreign investment, in the 1960's and 1970's the drive for an increase in exports also swept much of the developing world. This led development economists to come up with the first and most fundamental critique of export promotion in this fashion, which is often described as the "fallacy of composition." if the promotion of foreign investment and exports is the route for economic growth for a single country, is the same true when many developing countries choose this path?

In a review of the literature on the fallacy of composition, Mayer (2002) finds that labour-intensive exports from developing countries – i.e. exports promoted by utilising cheap labour – have

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<sup>9</sup> *Ibid.*

### *Bars on Export Promotion in the WTO*

As general trade liberalisation becomes a part of policy across the whole world, export-promoting policies are under increasing attack. They are criticised as unfair to the domestic industry of the importing country, who have to compete with exporters who are de facto receiving a subsidy in the form of tax breaks and tariff reductions. As a result, the WTO has increasingly insisted that export subsidies should be removed, failing which the exporting countries' goods may be subjected to countervailing duties by the importing country. This was eventually formalised in the WTO Agreement on Subsidies and Countervailing Measures. The actionable forms of export subsidies include direct tax breaks as well as providing goods and services to exporters at cheaper prices than to other domestic industries. The deadline for most developing countries to comply with this agreement was January 1, 2003 (UNCTAD 2003b).

Both of the above actionable policies feature in India's SEZ policy, making exports from EPZ's eligible for countervailing duties. India is already subject to the largest number of countervailing measures of any country in the WTO (Rao 2007).

suffered steadily declining terms of trade since the early 1980's. Indeed, the only exports that have escaped this tendency are high technology exports from the newly industrialising countries (the so-called "Asian Tigers", discussed in the next chapter). As with the "race to the bottom", the attempt to generate exports purely on the basis of cheap labour suffers diminishing returns as increasing numbers of countries adopt the same strategy – but this is very much what most EPZ's aim to do. This argument is particularly salient for 'latecomers' such as India.

A further critique emerged with respect to EPZ's specifically. Attracting FDI by reducing import costs – i.e reducing duties and tariffs on imports within EPZ's – tends to encourage import-intensive production. This results in high levels of imports, which may lead to a very low net export contribution. Hence the country's foreign exchange earnings, one of the key concrete benefits of exports, may not in fact grow significantly<sup>10</sup>. Moreover, the value addition of the local production base may be as simple as the labour required for assembly of pre-existing parts (stitching imported textiles, for instance), further reducing the contribution of the EPZ to either long-term export sustainability and technology transfer. The empirical data reviewed in the next chapter confirms that this is a serious problem with EPZ-based export promotion.

Finally, the importance of export promotion in a context of general trade liberalisation appears increasingly on the decline. When tariffs, duties and taxes are in any case low, further lowering them in order to promote exports is unlikely to have much impact. Moreover, it is now barred by WTO

<sup>10</sup> Amirahmadi and Wu 1995.

agreements (see box), and if done at all, must be done in a roundabout fashion.

The promotion of exports through EPZ's is hence likely to have similar effects to the impact on FDI. Export promotion through incentive provision leads to a diminishing rate of return, as well as shaping exports towards import-intensive sectors and reducing the gains from exports as well.

From the above we can see that different types of incentives and policies can produce very different results, to the point of affecting the entire industrialisation pattern and export composition of an economy. Whenever a particular incentive policy is chosen, a decision is hence also being made – consciously or unconsciously - about the investment and industrialisation pattern that the economy should follow.

The structure and method of deciding an incentive policy thus becomes tremendously important. It is not as simple as stating that what investors want should be provided. It is a question of deciding who should have power over the economy's development, and how that power should be exercised. The balance of power between investors, the state and other sectors of society thus becomes a key characteristic of any incentive policy. In particular, basing incentives on investor demands amounts to stating that there should be a *power shift* towards one section of society, namely big industrial and finance capital (particularly foreign capital). The degree, nature and effects of such a power shift will form one of the main themes of discussion in the rest of this study.

### ***The Use of Zones***

The other premise, and distinguishing feature, of an EPZ policy is the implicit or explicit decision to limit the application of these policies to a specified geographical area. This decision itself has had many critics. Those who support the application of incentives or regulatory relaxations across the whole economy criticise zones for limiting these measures to small areas<sup>11</sup>. More generally, zones are criticised for creating “enclave economies”, or areas that have few links with the rest of the

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<sup>11</sup> A typical quote, in this case from a World Bank economist, is: “How to prevent zones from giving countries a rationale away from improving the overall investment climate while giving the illusion that zones are solving all the problems? That is probably the World Bank group's biggest worry with zones. The government thinks that if they set up a zone that's all they have to do, that they don't have to work on the best of the environment, which is a big-big issue.” James Crittle, World Bank. This quote is taken from an online discussion on Special Economic Zones hosted on the World Bank web site at <http://www.worldbank.org/Discussions/Topics/Topic40.aspx>.

economy. Indeed, as noted above, the use of incentives tends to have this effect. Creating linkages thus requires deliberate planning, and it is precisely this that is often missing in EPZ policies. As Amirahmadi and Wu (1995) note at the end of a study on Asian EPZ's, "The EPZ's must be viewed at the intersection of three sectoral/spatial policies: free trade zones, industrial policy and growth centres. But many host governments emphasize only the free-trade or export-promotion aspect ... Consequently the establishment of EPZ in many developing countries becomes an isolated effort to promote manufactured exports."

The failure to integrate zones with the wider economy not only diminishes their value; it also may lead to wider distortions. Directing large amounts of public investment and subsidies towards zones deprives other areas of such investment, a fear that is particularly salient in the Indian context. Moreover, zones with low linkages may lead to an apparent very rapid growth in exports and investment, but disguise the fact that these gains may be dependent entirely on incentives and a fragile relative advantage over similar investment locations. When those factors change, the economy as a whole suffers from the vulnerability of the zones. The enclave nature of zones thus further complicates the problems with incentive policies noted above.

But this raises a further question: why should a country decide to have zones? At the policy level, there have historically been varying justifications. Some include:

1. A desire to limit the consequences of foreign investment and free market policies (a reason initially of great salience in China, as described in chapter 3);
2. Desire to attract FDI without removing protections for domestic sectors<sup>12</sup>;
3. Drawing investment into specific regions of the country (for instance, backward areas, or in order to decongest cities, as in the case of Thai EPZ's<sup>13</sup>);
4. Using EPZ's as "laboratories" to "experiment" with policies later intended for national application;
5. Likely strong resistance to such policies if implemented at a national level;
6. Ease of establishing infrastructure, of reducing bureaucracy and of simplifying procedures in a limited area.

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<sup>12</sup> Amirahmadi and Wu 1995.

<sup>13</sup> Jayanthakumaran 2003.

While each of these reasons gain salience in one or the other context, they can be summed up in one statement: for institutional, political or social reasons, incentive policies either *should not be* applied elsewhere (reasons 1 through 3) or *cannot* be applied elsewhere (reasons 4 through 6). Once again, as with incentives, the decision is closely linked to one's wider vision for the economy. In this case, the choice is about whether the creation of a potential 'enclave economy' and its consequences are desirable for the wider economy.

But what distinguishes this choice from the previous one is that it is beyond the domain of economic policy alone. By definition a zone is not an abstract policy entity – it is a *territory*, requiring an institutional machinery that covers not just 'economic' aspects but all issues of governance. Moreover, the institutions of a zone also define the policies and structures intended to control entry and exit from the zone. The latter applies both to capital, namely which companies receive exemptions, and in the simple physical sense of who is allowed within a zone.

By creating a zone, one is not merely creating an enclave; one is creating a new set of political institutions. The nature of these institutions is crucial, for three reasons. First, they will implement the required economic policies, by deciding on incentives, regulating economic activity and so on. Second, they will deal with all *other* questions of governance within the zone as well. Third, as new political institutions they will require adjustments and changes in the existing institutions of the state, such as tax and customs departments, police, etc., in order to adapt to them. Indeed the social and political critiques often made of zones – regarding workers' rights, environmental destruction, displacement, etc. - are all intimately related to the question of this institutional structure and its ability to respond to, and protect, the rights and interests of other sections of society.

In turn, the ability of this institution to implement these tasks will be – as in any institution – determined not just by its formal structure but by the power balance that underlies it. Just as the power balance in incentive policies is crucial to understanding those policies, so the power balance in zone institutions is crucial to understanding zones and their consequences.

## ***Conclusion***

With respect to Export Processing Zone policies, I have argued two main points. First, these policies combine potentially positive and potentially negative economic consequences. Second, the nature of both these consequences and their wider sociopolitical impacts depends on structures of

policy-making and governance. Moreover, these structures are not neutral bodies; they are affected by, and in turn affect, the balance of power in society.

Therefore, each of the remaining chapters in Part I of this study is divided into two broad sections. The first examines the zones in light of standard economic indicators such as exports and investments. This might be seen as the 'economic' impacts of zones. The second half broadens this analysis by asking the question: what can we outline about the politics of EPZ's in that particular historical context? There is naturally little 'data' as such that allows us to answer the latter question, but each chapter focuses on a few indicators about the 'political' aspects of zones<sup>14</sup>.

The hope is that viewed together, this will give us a broader picture of zones than either merely economic policy or social critiques would. This provides a frame of experience within which, in part II, the current SEZ policy in India can be examined.

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<sup>14</sup> In both cases the quotes are used advisedly, as the distinction between 'political' and 'economic' impacts is only an analytical tool, not a real phenomenon.



## CHAPTER II: EXPORT PROCESSING ZONES AND SPECIAL ECONOMIC ZONES AROUND THE WORLD

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As mentioned in the previous chapter, Export Processing Zones have been in existence for a very long time, but they have experienced a massive rise over the past three decades. They gained their initial foothold in Asia with the Kandla EPZ, created in 1965, but really began to grow following the decision by Taiwan and South Korea to intensify their export-oriented strategy – partly through EPZ's - during the 1960's . In the 1970's a large number of countries chose to continue on the same path, establishing EPZ's across the region.

International Labour Organisation (ILO) estimates now say that there were approximately 3000 EPZ's in the world in 2002. That figure does not include the enormous numbers of industrial parks, free zones and other areas which strongly resemble EPZ's but are not officially declared as such<sup>15</sup>. The rise in the number of EPZ's has been particularly sharp in the 1990's, as shown by the following table:

	<i>1975</i>	<i>1986</i>	<i>1995</i>	<i>1997</i>	<i>2002</i>
Number of countries with EPZ's	25	47	73	93	116
Number of EPZ's	79	176	500	845	3 000

*Source: ILO data from internal and official sources, as cited in ILO 2002.*

Moreover, such zones exist in industrialised countries, developing nations and emerging economies, though their characteristics vary widely in these areas. The focus here is on developing nations.

### ***The Economic Impact of EPZ's***

As said in the earlier chapter, let us first look at the economic policy experience of EPZ's. The diversity of experiences of zones notwithstanding, there are certain trends that emerge.

#### *Foreign Investment*

First, the fundamental justifications for most EPZ's – the desire to attract foreign investment.

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<sup>15</sup> ILO 2002.

There is limited data available on this issue, but those that exist show a mixed experience. Thus, in 1995, the percentage of foreign owned companies or joint ventures in EPZ's in Asia varied from 100% in Malaysia to 30% in China<sup>16</sup>. In 1983, at a time when competition for FDI was less intense among developing nations, FDI as a percentage of total investment in EPZ's varied in Asia from a high 90% in Malaysia (and 85% in Taiwan) to a low of 16.7% in, significantly, India<sup>17</sup>. Certain countries, namely Taiwan, Malaysia, South Korea and China, have had much greater success at attracting FDI in their EPZ's than other countries<sup>18</sup>. Outside Asia, the range is even wider, including countries such as Kenya where EPZ's "established at great expense have lain mostly idle"<sup>19</sup>. It should also be noted that there is a tendency for both the share of FDI within EPZ investment, and the share of EPZ FDI in national FDI, to decline over time<sup>20</sup>.

In short, as the ILO (2002) put it, "Both the number of EPZs and the number of countries hosting them have expanded rapidly. At the same time, however, some countries' zones have attracted zero or very limited FDI." UNCTAD (2002), examining FDI in ASEAN nations, found that "the relationship between the location of foreign affiliates and the location of EPZs seems, in general, to be weak." This variance fits with the discussion in the previous chapter on the factors that affect the placement of investment in zones – the mere establishment of incentive policies and special zones is not in itself sufficient for increased foreign investment.

The nature of investment in EPZ's also displays certain patterns. In Asia, the dominant investments came from two sectors – garments / footwear and electronics<sup>21</sup>. As predicted, both these industries have 'footloose' characteristics, in that they involve light manufacturing, easy relocation and a need for cheap and relatively unskilled labour. Further, the garments industry had another reason for investing in EPZ's – the attempt to take advantage of country production quotas under the now-defunct Multi Fibre Arrangement, an agreement on textile manufacturing (see box below).

The pattern is also that a single industry tends to dominate particular EPZ's, even if that is not the intended outcome. Interestingly, in a similar cross-Asia survey, Amirahmadi and Wu (1995) found that the number of large MNC's investing in EPZ's is remarkably low; most investment is by smaller investors. Finally, investment patterns in EPZ's also show certain distinct trends over time. Most

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<sup>16</sup> Jayanthakumaran 2003.

<sup>17</sup> Amirahmadi and Wu 1995.

<sup>18</sup> *Ibid.*

<sup>19</sup> UNCTAD 2002.

<sup>20</sup> Amirahmadi and Wu 1995.

<sup>21</sup> Jayanthakumaran 2003.

authors agree that EPZ's tend to have a “life cycle.” This cycle can be summarised as follows:

1. Basic infrastructure is constructed and investment begins to flow into zone;
2. Production and exports rise significantly, with one industry beginning to dominate;
3. After a short period, there is a “levelling off” of foreign investment and exports, labour skill levels and general costs rise, and – in some countries - high value added industries start to replace processing activities;
4. The importance of zone to export promotion then decreases, its role is reappraised and it has a tendency to reintegrate with the domestic economy<sup>22</sup>.

The last stage tends to accompany the shift of the country towards general liberalisation of imports and exports, a phase that already began in India in the 1990's.

It should be noted that all the examples generally quoted as 'successes' among EPZ's were those zones that attracted electronics and technology investment. But those countries whose EPZs failed to draw this kind of investment had a tendency to get locked into the “low value added” trap, where their EPZ's and exports became increasingly dependent on serving as low cost processing locations for foreign investors<sup>23</sup>. With multiple factors affecting production costs, booms in investment could soon translate into busts. A good example is countries with EPZ's dependent on the garments industry, for whom this trap became dangerous with the end of the Multi Fibre Arrangement. Indeed Jayanthakumaran (2003), writing two years prior to the end of the MFA in 2005, went so far as to predict that “the absence of guaranteed markets and cost advantages [due to the WTO's moves against the MFA and export subsidies]... will be a possible threat to the existing and new EPZ's.”

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<sup>22</sup> This sequence drawn from Ge (1999), Jayanthakumaran (2003) and Amirahmadi and Wu (1995), who give broadly similar presentations of this life cycle.

<sup>23</sup> UNCTAD 2002.

### *The Multi Fibre Arrangement and EPZ's*

The Multi Fibre Arrangement was an international agreement concluded in 1974 as a measure to protect industrialised countries' garments industries from cheaper competition from the developing world. The MFA specified quotas for textile exports from developing countries to developed nations. Garments manufactures therefore had a tendency to disperse production and relocate factories in order to take advantage of as many quotas as possible, particularly in the case of countries that were not producing up to their quota limits.

While many textile exporting countries suffered as a result, some countries – Bangladesh and Sri Lanka, for instance – saw a large inflow of garments manufacturing into their EPZ's as a result of MFA quotas. One study states that “there is a strong correlation between the growth of EPZ's and the Multi Fiber Arrangement” (Jayanthakumaran 2003). In 1999, garments formed 75.7% of Bangladesh's export earnings (Begun and Paul-Majumder 2000).

The Agreement on Textiles and Clothing in the WTO replaced the MFA in the 1990's, and was itself scheduled to expire in January 1, 2005. With the end of the MFA, the world garments market is now deregulated, with major consequences for countries with garments exports (see text).

Jayanthakumaran's prediction has turned out to be correct. With the end of the MFA, garments corporations are en masse shifting to China due to its extremely low costs. Data shows that as MFA quotas were removed on 29 types of garments in 2002, China's share in the US market for those garments jumped 31% to 59% in that year alone<sup>24</sup>. Glove exports from China increased by 291% while those from Guatemala, Bangladesh and Sri Lanka – three countries with textile-dominated EPZ's – fell by 65%, 48% and 47% respectively<sup>25</sup>. Hundreds of factories in Mexico are already said to have closed down.

This experience is a sober warning of just how risky EPZ-dependent export growth and development can become. Indeed, it serves as a specific case confirming the theoretical predictions made about investment in EPZ's in the preceding chapter – investment tends to be footloose in nature, dependent on fragile relative advantages and tends to narrow export orientation towards particular products and industries. This brings us to the question of the kind of exports that emerge from EPZ's.

#### *Exports from EPZ's*

From the point of view of the quantity of gross exports generated, EPZ's in many countries have been a phenomenal success. EPZ's fueled a rapid growth in exports in several countries, such as Sri

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<sup>24</sup> ICFTU 2003.

<sup>25</sup> *Ibid.*

Lanka – where clothing exports climbed from 623 million dollars in 1990 to over 2.7 billion dollars in 2000, mostly through EPZ's<sup>26</sup> – or Malaysia, which in 1982 was the world's largest electronics exporter, with 90% of production in EPZ's<sup>27</sup>. Zones in China, South Korea, Taiwan and Malaysia have notably produced large amounts of gross exports, while those in Sri Lanka and Philippines grew rapidly<sup>28</sup>. Moreover, in some countries EPZ's became the predominant source of export production, particularly in Latin America. In Mexico, zones produced over 50% of manufactured exports and in the Dominican Republic more than 80%<sup>29</sup>. In Malaysia and Sri Lanka, EPZ exports formed 49% and 44% of total manufactured exports in 1982 and 1990 respectively<sup>30</sup>.

Moreover, in dynamic terms, EPZ's also are said to have helped change the export composition of some countries from primary commodities (unprocessed food and raw materials) into manufactured exports. Thus, Mexico's production of television receivers went from less than 0.01% of world market share in 1990 to 23.01% in 1999<sup>31</sup>. Garments industry EPZ's have built new export markets for many countries through the Multi Fibre Arrangement.

Such stunning figures and anecdotes are often cited to demonstrate the power of EPZ's to fuel exports, particularly since many of them demonstrate skyrocketing growth in short periods of time<sup>32</sup>. But these figures only tell us about revenues, not about costs that accompanied this growth; indeed, they don't tell us the most basic cost, which is the amount of imports required for the said exports<sup>33</sup>. Deducting the cost of imports – i.e calculating *net* exports rather than *gross* exports – changes the picture considerably.

Citing data from the 1980's, Amirahmadi and Wu (1995) find that, of seven high performing Asian economies, net exports (gross exports minus imports) from EPZ's ranged from at most 60% (in Indonesia) to 16% (in China) of gross exports from the zones<sup>34</sup>. The average figure is around 30% in most countries. Since it is net exports that are economically significant, such low ratios of net exports to gross exports considerably reduce the positive impact of the zones. Further, this low level of net exports also reflects an even lower rate of value addition in the zones, which typically depended on

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<sup>26</sup> ICFTU 2003.

<sup>27</sup> Jayanthakumaran 2003.

<sup>28</sup> Amirahmadi and Wu 1995.

<sup>29</sup> UNCTAD 2002.

<sup>30</sup> Amirahmadi and Wu 1995.

<sup>31</sup> ILO 2002.

<sup>32</sup> See for instance UNCTAD 2002.

<sup>33</sup> Amirahmadi and Wu 1995.

<sup>34</sup> The countries covered were Sri Lanka, China, Indonesia, Philippines, Malaysia, South Korea and Taiwan.

low-level manufacturing and unskilled labour. The overall rate of value addition in Asian zones was generally lower than 20%<sup>35</sup>.

This does not nullify the export contribution of EPZ's, but it does lessen its significance. Further, this kind of export promotion may have two parallel effects: on the one hand, decreasing countries' external vulnerability by reducing their dependence on primary commodities, but on the other, increasing their vulnerability by pushing them into an even narrower export orientation that depends on specific manufactured commodities. The best instance of the latter is the garments EPZ's, as described in the preceding section. Thus, in Sri Lanka, EPZ exports – mostly in garments – constituted nearly 50% of the country's total exports<sup>36</sup>, exposing that country to serious vulnerability with the end of the Multi Fibre Arrangement.

### *Linkages and Technology Transfer*

With respect to linkages with the rest of the economy, the data finds that in Asia, backward linkages in the form of local purchases of raw materials are, once again as predicted, very low. This appears to be true even when the dominant industry is garments and textiles, where local raw materials are widely available. Thus, in Sri Lanka, local purchases were around 5% of total purchases, while in the Philippines the figure did not exceed 10%.<sup>37</sup> Countries such as Malaysia with electronics-dominated EPZ's had even lower figures<sup>38</sup>. Raw materials typically come from outside the country, often for quality and time reasons.

This leaves us with technology transfer. This can occur through several methods, including directly through training of supplier companies and training of workers and staff, or indirectly through demonstration effects and the general impact of “modern” management and market techniques. Such effects are of course very difficult to measure, but what little information is available seems to indicate that this does not happen either. First, for the electronics and garments industries that dominate most EPZ's, there are inherent problems – garments technology is cheap and widespread, and electronics companies guard their technologies closely<sup>39</sup>. Secondly, technology transfer is most likely to occur where capital-intensive and new technologies are being applied, and this is unlikely to occur in the low skill, labour-intensive environments of most EPZ factories. Research and development functions in

<sup>35</sup> Amirahmadi and Wu 1995.

<sup>36</sup> ICFTU 2003.

<sup>37</sup> Jayanthakumaran 2003.

<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid.*

particular usually take place in the home countries of foreign investors, not in EPZ's<sup>40</sup>. Where electronics industry EPZ's do exist, there are certainly some spillover effects, such as the result of technical training of workers and the upgrading of technical skills of managers<sup>41</sup>. But the overall conclusion of most studies that exist is that the technology transfer of EPZ's is minimal.

The net result is that the characterisation of EPZ's as “enclave economies”, at least in material terms, does not seem far off the mark. Highly dependent on imports, with low linkages either in material or information terms with the local economy, and often dominated by a single industry, EPZ's are generally quite isolated – both in positive and negative terms – from the rest of the economy.

### *Employment*

The final linkage to be considered is employment. Strong growth in employment has been associated with EPZ's, particularly in China, where SEZ's, EPZ's and other forms of zones (see below) employ close to 30 million people. The figure for the rest of the world was estimated at 7 million in total by 2002<sup>42</sup>. Of course, however, the question remains as to what extent this is “new” employment; thus, employment grew by 10.5% in the *maquiladoras* (export-oriented factories) of Mexico in 1995, but fell by 9% in manufacturing outside the zones, indicating that labour simply migrated rather than much new employment being created<sup>43</sup>.

Moreover, as a result of the presence of multinational corporations and factory-sector employment, wages in EPZ's tend to be slightly higher than those outside, though here as well the experience is mixed. Malaysia's EPZ's had an average wage around 30% higher than that outside the zone, and in the Masan zone in South Korea wages were approximately 10% higher. But at least one third of the workers in Chinese, Sri Lankan and Phillipine zones receive less than the minimum wage<sup>44</sup>.

### *Zones As Political Institutions*

How should we gauge the political experience of zones on a worldwide scale? Clearly, it is impossible to generalise across political realities and conditions. But we can identify some aspects by noting one institutional trend that has dogged EPZ's everywhere – the conditions of labour.

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<sup>40</sup> Amirahmadi and Wu 1995.

<sup>41</sup> *Ibid.*

<sup>42</sup> ILO 2002.

<sup>43</sup> Jauch 2002.

<sup>44</sup> Jayanthakumaran 2003.

Proponents of EPZ's often end their discussion of labour with the data provided above, establishing that EPZ's often create employment and sometimes pay higher wages. But, as with “investment”, the term “employment” is an aggregate category – it does not tell us *who* is being employed, and *what kind* of employment they are receiving. Once we begin to ask these questions, we are forced to confront the politics of EPZ's.

Let us start with the most striking feature of EPZ workforces - the overwhelming predominance of young women. As per 1995 data, 70% to 80% of the workforce in Asian EPZ's is women between the ages of 16 and 25, and in some zones it may reach 90%<sup>45</sup>. Indeed, women are in a sense sequestered into the EPZ and export sectors - within the emerging Asian economies, women's share of the labour force in export-oriented manufacturing is generally almost twice as high as their share in the labour force as a whole<sup>46</sup>. Moreover, this share has been rising over time<sup>47</sup>.

This remarkable gender imbalance is often noted and, at times, considered a positive contribution to the empowerment of women. Proponents of EPZ's have argued that the provision of formal organised sector employment opportunities to young women is a step forward, given that such opportunities are rare in developing countries. Certainly, when the choice is between EPZ employment and insecure and often dangerous unorganised sector employment, the former does look more attractive.

But this is only one side of the story. EPZ employers do not engage women out of altruism, a point that bears repeating in the context of arguments that sometimes portray EPZ's almost as bastions of liberation from patriarchy. The reason for the prevalence of women is not hard to discern. In a “zone” devoted to manufacturing investment drawn by cheap labour, employment will tend to be monotonous, repetitive and exhausting. Profits thus become proportional to the extent to which businesses and government institutions can discipline and repress their workforces.

In such a context, women workers are far easier targets. As the International Confederation of Free Trade Unions (2003) puts it, “Women, who are considered to be disciplined, meticulous and more compliant than men, and therefore less likely to join a union, are a godsend for unscrupulous employers, who, moreover, prefer them to be young, single and without children.” Moreover, they can be subject to a whole range of patriarchal threats and restrictions, including termination of employment

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<sup>45</sup> Amirahmadi and Wu 1995, ILO 2002.

<sup>46</sup> See data provided in Seguino 2000 for Hong Kong, Korea, Malaysia, Phillipines, Singapore, Sri Lanka, Taiwan and Thailand.

<sup>47</sup> *Ibid.*



upon marriage, restrictions on freedom of movement, and sexual harassment. Documented instances of such practices include the imposition of pregnancy tests in many Latin American EPZ's and state-sanctioned "marriage bans" in Korea<sup>48</sup>.

Women can also simply be paid less for the same work. Seguino (2000) argues that this was in fact a key part not only of microeconomic profit decisions by companies but of the entire export success of the Asian nations. The repression of women's wages allowed for both greater profits for corporations and lower prices of finished goods, making a strong contribution to economic growth. Further, given gender imbalances, lowering of women's wages does not have the same political consequences as repression of men's wages. Thus she finds that in nine Asian nations in her study, women's wages ranged from 50% those of men to up to a maximum of 87%, and there is a strong statistical correlation between gender wage inequality and economic growth.

In short, EPZ incentives promote a certain form of industry that lead to a unique women-dominated workforce, governed both by formal institutions (factory management) and wider social repression (bias against women), which together exercise extreme discipline. But what about the formal institutions of the state? How have they been involved in this process?

For most commentators this question is reduced to the applicability or otherwise of labour laws, and there is a common impression – among both proponents and opponents of labour laws – that most EPZ's are exempted from such laws. Depending on one's position, this is either said to contribute to greater violence against workers or to higher 'productivity' and investment. But in fact this is factually incorrect: the majority of nations do not exempt EPZ's from labour laws<sup>49</sup>. At the most, many declare EPZ's to be "essential services", "activities vital to the national interest", or other phrases that are the equivalent of the "public utility" designation under the Industrial Disputes Act in India, which have the effect of basically barring strikes<sup>50</sup>.

But this does not mean that workers' rights are protected, for it is here that the institutional structure of EPZ's becomes glaringly clear. In addition to the violations of women's rights noted above, abuses in the form of arbitrary dismissals, failure to pay minimum wages, violations of the right to form unions, and physical violence such as beatings and killings are very common<sup>51</sup>. Working conditions and frequent retrenchment ensure that the workforce turnover rate in EPZ's is up to 30% or

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<sup>48</sup> ICFTU 2003 and Seguino 2000.

<sup>49</sup> ILO 2002.

<sup>50</sup> ICFTU 2003.

<sup>51</sup> ICFTU 2003.

40%<sup>52</sup>. Indeed, Latin American and Asian textile industry EPZ's have become so notorious for labour abuse and violence that a consumer movement in the US and other industrial nations has come up in the past decade, demanding that multinationals that operate in such locations respect labour rights<sup>53</sup>.

Workers' ability to demand their rights or improvements in conditions are made more difficult by three factors. First, as seen in the next two chapters, the state machinery within zones normally takes a clear stand against any form of worker agitation, legal provisions notwithstanding. Government inspectors are often instructed not to inspect EPZ factories and penalties are rarely enforced<sup>54</sup>.

Second, the very nature of EPZ investment makes employment insecure, given the possibility of foreign investors simply closing shop and leaving. An illustration is provided by a study by Lee (1999) of the Masan EPZ in South Korea. He finds that, in the wake of labour struggles for rights during the democratisation of the country in 1987, at least two major investors closed their factories in the zone – one without any severance payment or notice to workers. Other investors engaged in restructuring that eventually reduced employment in the zone by more than 50%.

Third, almost every labour union report on EPZ's anywhere in the world, including India, notes the extreme difficulty of physically entering the zones. Zones are ringed with barbed wire fencing, workers are prohibited from speaking to outsiders or sometimes even to each other, and any entry of 'outsiders' is generally barred. Within zones, constant supervision and intense security make any form of union organising extremely difficult.

The nature of EPZ investment and production thus generates a particular kind of employment and a particular institutional reality. The combination of the undermining of normal governance institutions (effectively negating the letter of the law), the shift in power towards investors (leading to particular forms of investment and insecurity of employment) and the territorial isolation of the zone produce what can only be called a labour *regime*. This regime is one in which low skill levels, high turnover, extreme insecurity and repression combine to force workers into severe conditions, their value in inverse proportion to their wages. There may be variations in the degree to which this occurs, but it seems a pattern across most EPZ's.

There are those who dismiss such criticisms as romanticism. Unorganised sector and daily wage work in countries like India, it is pointed out, are *de facto* exempt from labour law in any case

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<sup>52</sup> ICFTU 2003.

<sup>53</sup> See for instance the web sites of United Students Against Sweatshops ([www.usasnet.org](http://www.usasnet.org)), the National Labour Committee or the Worker Rights Consortium ([www.workerrights.org](http://www.workerrights.org)).

<sup>54</sup> ICFTU 2003, ILO 2002.

and workers are subject to extreme and criminal pressures. As noted above in the context of women, EPZ employment is certainly seems better than such abuse.

But this criticism entirely misses the point. This model of employment not only violates workers' rights in a brutal manner; it also defeats many of the economic gains expected from foreign investment and expansion of industrial production. Such forms of employment lead to little additional training, upgradation of the workforce or technology transfer. This in turn contributes to a vicious cycle where low investment in the workforce results in lower levels of attachment to a particular production site, leading to higher levels of capital mobility and overall instability of investment. The labour regime described here is thus bad for both workers and the economy as a whole. Those seeking to propel an economy towards higher levels of consumption and human dignity cannot see such a regime as their model.

### ***Some EPZ 'Success Stories' and Their Politics***

The experience of labour grants us some insights into the manner in which zone institutions tend to work, and their general bias towards capital. But what about the other institutional question posed by zones – the balance of power in policy making itself? We can gain some more insights into this by examining some commonly cited 'success stories' of EPZ's. In particular, three countries – China, Taiwan, and South Korea – are often cited as major successes in using EPZ's as part of their industrialisation strategy. The Chinese experience is considered in more detail in the next chapter. A brief look at some common features among the other two experiences is of interest, for it demonstrates the crucial importance of the political aspects of EPZ's.

First, there were historical conditions that existed in these nations that provided a particular context for EPZ's and export oriented policies. Both countries were seen as 'bulwarks' against Communism by the United States, which had two effects. First, under American occupation in the case of Korea and under the Kuomintang in Taiwan, sweeping land reforms were undertaken to reduce peasant discontent. The result was largely the elimination of parasitic landlordism and the freeing of agricultural surpluses for use in industrialisation<sup>55</sup>. Second, these countries received preferential treatment from the US and open access to export markets in that country.

These two historical advantages were accompanied by a conscious and specific plan for the use

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<sup>55</sup> Kay 2002.

of EPZ's. EPZ's were established in these countries earlier than in most other developing nations, as the shift away from import substitution towards export orientation began<sup>56</sup>. They formed one part of a targeted strategy of using directed credit, controlled exchange rates, sector-specific incentives, disciplinary measures against both capital and labour, and similar state instruments to direct investment into favoured sectors and encourage exports in those sectors<sup>57</sup>. The specific focus on the electronics industry was part of this plan, and, as noted throughout this discussion, the electronics industry – while it shares the problems noted above – is comparatively more likely to contribute to longer-term investment and technology transfer than the garments industry. Moreover, the 'footloose' nature of incentive-driven investment was partly curbed by restrictions that made capital flight very difficult, while both domestic and foreign investors were provided further incentives if they reinvested their profits<sup>58</sup>. Investors were provided infrastructure and tax breaks but in turn subjected to regulations that suspended incentives and credit if high performance standards were not met. This context of planning contributed in no small measure to the EPZ's success, for, as UNCTAD (2003) notes, “Countries that pursue more integrated approaches for attracting export-oriented FDI - placing FDI policies in the context of their national development strategies and focusing on productivity improvements, skills development and technology upgrading - have tended to attract higher quality FDI.”

A further salutary lesson is to note what occurred as, in the late 1980's, these countries abandoned their earlier policies and shifted more towards general liberalisation and capital account convertibility – the classical 'liberalisation' model now promoted in India and elsewhere. In the first place, this led to the relative decline of EPZ's in these countries as their incentives and policies became less attractive<sup>59</sup>. Second, these new policies contributed directly to the crash of the Asian economies in 1997, which wiped out many of the gains that they had won in earlier years.

Even the EPZ success stories, then, were the result of a political decision to counter the shift in power in favour of investors with a compensating discipline that forced investment in preferred directions and towards preferred sectors. The striking contrast with the Indian experience, or that of most countries, is apparent. Yet even these 'successes', it should be noted, were battered when full liberalisation was undertaken. Moreover, the price paid in political and social terms for this model – undertaken by authoritarian governments that crushed all dissent, and, as we saw above, suppressed

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<sup>56</sup> Amirahmadi and Wu 1995.

<sup>57</sup> There is a great deal of literature on this subject. See for instance Morrissey and Nelson (1998).

<sup>58</sup> Jomo 2001.

<sup>59</sup> *Ibid.*

women's wages and promoted repression of workers – is rarely discussed, but should not be forgotten.

## ***Conclusion***

In sum, the experience of EPZ's in other parts of the world provides us a number of lessons. The investment and export patterns of EPZ's bear out many of the theoretical predictions made in chapter 1, namely that aggregate growth of investment and exports often occurs, but is not necessarily accompanied by technology transfer, export diversification or foreign exchange earnings as expected. The second and third sections demonstrate how the political aspects of EPZ's – the labour regime within them and the balance of power in the zone policy – are crucially linked to these patterns, demonstrating that even those limited 'successes' that have occurred have done so for political reasons and not as a result of the EPZ policy alone.

On the basis of these lessons, we can then examine the experiences of Chinese and Indian zones to gain a better understanding of the way these factors work.

## CHAPTER III: THE CHINESE EXPERIENCE

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Almost every aspect of the Indian debate on Special Economic Zones, both from the point of view of supporters and from that of critics, is informed by a shared impression of the Chinese SEZ experience. Regarded as a major success, China's SEZ's are often said to be an 'engine' of China's export boom, with their special policies, incentives and infrastructure drawing large-scale foreign investment and fueling employment growth and foreign exchange revenues. As a Member of Parliament put it during the debate on the passage of the Special Economic Zones Act, 2005, "China is a shining example of a country which has developed through its Special Economic Zones. Various facilities given have attracted foreign direct investment and they have gone a greater extent in developing their economy."<sup>60</sup>

Meanwhile, critics in India frequently use the Chinese policy as a benchmark for comparison. Key differences with India's policy often cited include the number of SEZ's in China – ostensibly only six in total, their large size and the fact that the government retaining ownership over the land. These three criticisms in particular are echoed by large numbers of commentators from both the left and the right, ranging from the Left parties' official position to sharp remarks in *The Economist*<sup>61</sup>.

But the reality is that this shared image of Chinese SEZ's is both incomplete and, in many respects, simply wrong. As we shall see in this exploration, China has far more than six zones, they have by no means been an unqualified success, and they have brought about severe economic and social problems in their wake. Understanding what really happened in China is key to understanding India's SEZ policy and its possible consequences. For that, it is necessary to look both at the history of China's special zones and their effect on the Chinese polity.

### ***Background and History***<sup>62</sup>

It bears repeating, in any history of China's SEZ policy, that these zones were undertaken not in the context of a capitalist economy – unlike all the other Asian EPZ's studied and the Indian SEZ's – but in that of a socialist command economy, where property was collectivised, contract labour

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<sup>60</sup> Statement by Professor M. Ramadass, Member of Parliament, Pondicherry in the Lok Sabha on May 10, 2005.

<sup>61</sup> Note of the Left parties to the United Progressive Alliance government dated October 19<sup>th</sup>, 2006, and *The Economist* 2006.

<sup>62</sup> The discussion in this section draws on Reardon 1996 unless otherwise specified.

unknown, and social security and worker protections very strong. This fact is commonly forgotten in comparisons between Indian and Chinese SEZ's, and, as we shall see, it is quite critical to understanding the trajectory that these zones eventually took.

China's Special Economic Zones policy has its roots in earlier efforts at creating Export Processing Zones, efforts that date back to 1960. The main goal at the time, and indeed until 1982, was the increasingly desperate need for foreign exchange to finance debts, cover food shortages and drive an import substitution programme. The zones were however repeatedly created and then rolled back as China's political environment swung between efforts at autarkic development (such as the Great Leap Forward) and more “pragmatic” development strategies and import substitution. The last such swing occurred in the early 1970's as the Cultural Revolution came to an end, and the new leaders of China – particularly with the rise of Deng Xiaoping to power in 1978 – focused heavily on import substitution as a new industrialisation programme.

It was in this context that the first Special Economic Zones were created by Documents 79.50 and 79.202 of the State Council, issued in 1979. The new regulation created the Shenzhen and Zhuhai Special Economic Zones in Guangdong and Fujian provinces respectively, and allowed for foreign investment in these zones, removed customs duties and lowered taxes. The provisions of the command economy were relaxed and contracts for labour permitted. The new regulations also decentralised control over the management and financing of the zones to the provincial governments of Guangdong and Fujian, a new step in China's hitherto highly centralised planned economy. The provinces were also permitted to keep the foreign exchange revenue received from these zones.

The political understanding underlying the Zones was that of promoting partial capitalist relations in some areas, largely in order to address their regional development and simultaneously earn foreign exchange, while insulating the remainder of the economy from the consequences of this kind of 'opening.' It was for this reason that the first two zones were sited in China's southern coast, which had poorer infrastructure, relatively lower growth and had lost much of its population to migrations to Hong Kong. Hence also the large initial areas of these zones<sup>63</sup>. SEZ's were thus part of a regional development strategy at first.

The provincial governments, while empowered to manage the new SEZ's, soon found themselves lacking resources to build the necessary infrastructure in these poor and outlying regions. This set the stage for large scale invitation of foreign investment into the Zones, and thus between 1979

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<sup>63</sup> Wong 1987.

and 1981 the share of foreign investment in Shenzhen's infrastructure rose from 11% to 50%. Most of this capital came from Hong Kong and was invested in land development, residential housing and tourist development. Meanwhile, two more zones were created in 1980, in Shantou and Xiamen<sup>5</sup>; both were initially smaller, more traditional EPZ's, but later expanded to fit the larger SEZ model (from 1.6 sq km to 52.6 sq km in the case of Shantou and 2.5 sq km to 125.5 sq km in the case of Xiamen)<sup>64</sup>.

But no sooner had the zones been created that problems began to arise. The zones became centres of trade, both legal transactions and illegal smuggling, in durable goods. The result was a rapid rise in the entry of consumer durables and attendant threats to local industry, foreign exchange shortages and possibilities of rising inflation. As a result, strong opposition emerged within the Chinese Communist Party. The Chinese government clamped a moratorium on further SEZ's in December 1981 and reviewed the strategy, subsequently imposing bans on imports of 17 durable goods and constructing a barbed wire fence between Shenzhen and the rest of the country.

In 1982, however, as China began its overall shift towards “market socialism”, the function of the SEZ's began to change. They were now to serve as part of national development, and particularly as part of what eventually became the “coastal development strategy” of drawing investment and export production into the coastal cities. This new strategy, though not formally announced till 1986, was based on three tiers: the SEZ's would have the most 'open' and laissez faire economic policies and investment regulations; the fourteen 'Coastal Cities' would have open, but not so open, policies in order to draw investment, technology and generate a high rate of savings for further investment; and the interior regions of the country would focus on production for the domestic market and eventually on picking up the successful policies of the other two. Over the 1980's, measures of liberalisation in SEZ's included competitive bidding for construction, “contract responsibility”, labour contracts, floating wages, liberalised banking and so on. This three tier hierarchy was also a hierarchy of experimentation, with the SEZ's being the 'laboratories' of new policies.

As a result of these political changes the Special Economic Zones became the nationally endorsed symbol of economic growth and progress, with Deng Xiaping doing “southern tours” in 1984 and 1992 to further advocate the sociopolitical and economic practices within the SEZ's as the model for the rest of China<sup>65</sup>. It should be noted that this policy of gradualist liberalisation, with SEZ's as the vanguard of 'market socialism', differed from the Taiwanese and South Korean models (in which zones

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<sup>64</sup> *Ibid.*

<sup>65</sup> Cartier 2001, Weil 1996.



were not given such central political importance). Contrary to popular impression, however, this integrated plan did not succeed in many of its aspects.

## ***Economic Aspects***

### *Foreign Investment*

Perhaps the biggest claim circulated in India about the Chinese SEZ's is their success in drawing FDI. There is no doubt that China's SEZ's, particularly the four original zones, have drawn enormous amounts of foreign investment. By 1984 alone, the two original SEZ's of Shenzhen and Zhuhai had drawn 316 million dollars of foreign investment<sup>66</sup>, and by 1995 Shenzhen had the fifth largest GDP of China's cities and had remitted almost RMB 50 billion to the Central government<sup>67</sup>. In 1984 the four zones had received 26% of the total FDI in China<sup>68</sup>. Most of this investment was drawn to manufacturing, which drew almost 50% of the investment in three zones (and 26% in the remaining one, namely Zhuhai, where interestingly 'transport and communication' received 33%)<sup>69</sup>. Most of this investment was in the form of fully foreign owned firms, joint ventures and “cooperative ventures” (where the foreign firm provided technology, management, equipment etc. and the Chinese firm provided land, construction and labour)<sup>70</sup>.

But four caveats must also be drawn in this story of rapidly rising foreign investment. First, it is not surprising that foreign investment came into the SEZ's at a higher rate than into the rest of China, considering in the rest of China even capitalist market relations did not exist. Second, after 1985, the imposition of new Central government restrictions on the SEZ's as well as the opening of the coastal cities greatly diminished the attractiveness of the SEZ's for foreign investment. As a result, in the first half of 1986, pledged investment and realised investment were lower by 70.8% and 86.5% respectively than in 1985<sup>71</sup>. Moreover, domestic investment in the SEZ's was still higher than such large amounts of foreign investment through the mid-1980's<sup>72</sup> – and we can assume that such domestic investment came primarily from the public sector, since the private sector in China was not yet fully open.

Third, there were significant differences in the experience of the different SEZ's. Shenzhen – the most quoted example – is in a sense also quite unusual. In 2006, *Business China* reported that

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<sup>66</sup> Wong 1987.

<sup>67</sup> Reardon 1996.

<sup>68</sup> .Wong 1987.

<sup>69</sup> Wong 1987.

<sup>70</sup> *Ibid.*

<sup>71</sup> *Ibid.*

<sup>72</sup> *Ibid.*

“only one of the original four zones can truly be called a runaway success – Shenzhen. Xiamen remains... [at most] a successful second-tier investment location. The same is true of Zhuhai.” Shantou, the remaining zone, was never very successful, as can be seen by comparative 1980's data<sup>73</sup>, and was hit by a major scam in 2000.

Finally, as has been commented very frequently, much of the foreign investment came from Hong Kong and Macao, particularly in the case of Shenzhen. Thus 88% of the new ventures in the SEZ's between 1981 and 1983 involved investors from these two locations<sup>74</sup>. By 1995, Hong Kong manufacturers employed 4 million people in Shenzhen but only 500,000 in Hong Kong<sup>75</sup>, and 96% of Shenzhen's textile industry and 95% of its garments industry was owned by Hong Kong investors<sup>76</sup>. The migration of capital from Hong Kong (and, in the case of Fujian, Taiwan) to Chinese SEZ's was thus no small factor in their success. Without these enormous sources of capital, the story of China's SEZ's would perhaps have been different.

### *Exports*

A similar mixed tale occurs with respect to exports. In the early years in particular, the SEZ's did not succeed in terms of massive exports, with the partial exception of Shenzhen – whose exports grew at around 70% per year on average between 1980 and 1995<sup>77</sup>. Both exports and foreign exchange earnings were hampered by the enormous expenditure on construction and infrastructure provision<sup>78</sup>. Moreover, the incentives provided greatly decreased the ability of the Chinese to retain foreign exchange earnings, particularly in a context of very high levels of imports – both for production and for consumer durables<sup>79</sup>. Indeed, the import intensity of Chinese SEZ's is so high that, as of 1990, the *net* exports of Shenzhen, Zhuhai and Shantou SEZ's was barely 16% of their gross exports<sup>80</sup>, approximately half of the already low figures for most Asian EPZ's. It is for this reason that Amirahmadi and Wu (1995) describe the SEZ's more as “import processing zones” while Wong (1987) describes them in their early years as “trade based economies.”

It is also notable that one major reason for this was, as mentioned above, the capital devoted to

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<sup>73</sup> See Wong 1987.

<sup>74</sup> *Ibid.*

<sup>75</sup> *The Economist* 1995.

<sup>76</sup> Lau 2001.

<sup>77</sup> *The Economist* 1995.

<sup>78</sup> Wong 1987.

<sup>79</sup> *Ibid.*

<sup>80</sup> Amirahmadi and Wu 1995.

construction. Indeed, by 1986 the Chinese government was forced to impose restrictions on the construction of hotels, restaurants and commercial buildings<sup>81</sup>. In light of the enormous real estate interest in India's proposed SEZ's, this is a salutary lesson to keep in mind.

Where SEZ's did succeed to some extent in exports was, as in other Asian EPZ's, in promoting new sectors of manufacturing. Electronics in particular became a growing export from the SEZ's. Yet despite this, SEZ's through the 1980's still had a much lower share of trade and exports than the traditional trading cities of the coast<sup>82</sup>.

### ***Wider Consequences***

Thus the 'success' of SEZ's in China, even from a narrow point of view, is not quite as complete or extraordinary as it is often portrayed to be. But what is more important from our point of view is that, as the political justification of SEZ's changed – from being limited regional development centres to the vanguards of 'market socialism' – the result was in fact to lessen their economic 'success', as the distinction between these islands of capitalist property relations and a predominantly socialist command economy faded. But the latter phase, with SEZ's as vanguards, also had a different set of sociopolitical impacts, two of which in particular are very relevant to the Indian situation.

### ***Real Estate Speculation, “Zone Fever” and Loss of Agricultural Land***

Perhaps the biggest concern about India's SEZ's is the potential for real estate speculation and the concomitant fear of the loss of agricultural and fertile land. In this case the experience of China is both instructive and frightening.

Though land in China is technically the property of the state, by the late 1980's SEZ's in particular were leading in efforts to put in place the legal foundations for trade in use rights and leases<sup>83</sup>. Under China's 1987 Land Administration Law, the country's first, use rights were created and provincial governments, municipalities and SEZ's were also empowered to create their own land regulations as long as they did not contradict the national legislation<sup>84</sup>. As a result, by 1991 administrative allocation of land gradually gave way to property markets, again particularly in SEZ's<sup>85</sup>.

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<sup>81</sup> Wong 1987.

<sup>82</sup> *Ibid.*

<sup>83</sup> Huang and Yang 1996.

<sup>84</sup> Cartier 2001.

<sup>85</sup> Huang and Yang 1996.

The result was a rapidly rising real estate market. Moreover, this market had some features that were, ironically, uncannily similar to those prevalent in India today. In China, land in urban areas belongs to the state and in rural areas to the village commune. In rural areas, however, families had been given individual contracts to their lands as part of the reforms to the village communes in the 1980's<sup>86</sup>. But only urban land use rights could be transferred to private parties. Rural land use contracts could be transferred only to the state, which then had the power to sell development rights on it. As the Chinese state began to increasingly swing in favour of big business and market socialism, this system had the perverse effect of making farmers' tenure fundamentally insecure, especially in areas near expanding municipalities and within SEZ's. Despite periodic revisions to the compensation offered by the government, such compensation was generally lower than the already low 'market' value of these lands. This was combined with the presence of large-scale informal negotiations for land and administrative intervention, in both urban and rural areas, as a result of which the “market” itself was distorted<sup>87</sup>.

The similarities with India's land market, and the speculative possibilities of state-driven acquisition of rural lands, are strikingly apparent. The result in China was the rise of a speculative market in land rights with low cost acquisition by the state and rapid transfer through speculators, each making money by reselling the rights at a higher price. This “stir frying”, as the practice was referred to, was reflected in the national statistics on land transfers: between January 1992 and July 1993, rights over 127,000 hectares of land were granted to real estate developers across China, but only 46.5% of this land was actually developed.<sup>88</sup>

The Special Economic Zones played the leading role in the resulting chaos and speculation over land. This was the result of what was called “zone fever”, namely the rapid multiplication of zones across China as a result of continual promotion of these zones as a model for the Chinese economy. Imitation of these zones became the practice of the day for national, provincial and local governments. The national government itself followed the initial SEZ's with a new SEZ in Hainan, declared in 1988, and after 1984 with a series of Economic and Technical Development Zones and National Industrial Development Zones for New and Advanced Technology. These latter types of zones were smaller, typically closer to or within existing cities, and focused on high technology<sup>89</sup>. By 2006, there were 54

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<sup>86</sup> Weil 1996.

<sup>87</sup> Cartier 2001.

<sup>88</sup> Huang and Yang 1996.

<sup>89</sup> Reardon 1996.

such ETDZ's and NIDZNATs<sup>90</sup>.

Meanwhile, provincial and local governments went ahead with declaring special zones for industry, providing incentives and, most of all, land to industries and real estate speculators. During the first three years of the 1990's, this reached such a pitch that there were no accurate figures on how many such 'development zones' actually existed in China. Estimates from 1993 range from 6000 to 8700 such zones, and the total area of such zones by 1992 was estimated to be 15,000 square kilometers – more than the built up area of the existing cities<sup>91</sup>. Many of these zones were established contrary to national or provincial regulations, and by 1994 the national government had cancelled over 1,000 such zones<sup>92</sup>.

From the existing zones, a striking example of the kind of real estate speculation that was occurring is the SEZ of Hainan. *The Economist* reported in 1992 that Hainan was the “world's biggest speculative bubble”; Hainan had “few industrial firms and little industrial output.” Indeed, the description bears quoting *in extenso*:

Everyone in Hainan has money to burn. It comes from finance and property... Frustrated would-be investors can always turn to the property market. Nobody any longer keeps track of the number of 30- and 40-storey office buildings being put up by round-the-clock construction crews. Luxury flats and villas are being built at a similar pace. One banker says the cost of land for office buildings has gone up 2.5 times in the past year. The land of one prime site, bought four years ago for 200 yuan a square metre, is now worth around 2,500 yuan a square metre.

This is not happening because anybody--with the exception of finance companies--actually wants to use the space. Whole floors, indeed most floors, of the office buildings are empty, and practically none of the new flats and villas is lived in. Industrial parks... are home to bonded warehouses, brass-plate “industrial” companies supposedly in the import reprocessing business, or nobody.

What is going on? Speculation, almost pure and simple, and tax evasion. ... A name on a door in Haikou can mean income taxed at 15% instead of 55%. Property investments are immensely lucrative so long as a sucker from China's interior is behind you in the queue. Imports that would be hard to arrange on the mainland can be routed through Hainan.

Indeed, 1993 figures show that almost half of the available housing in Hainan was unoccupied, even as construction was underway that would double the available housing units<sup>93</sup>. In June 1998, the Hainan Development Bank, the main banker to the provincial government, closed down under bankruptcy<sup>94</sup>.

The “zone fever”, along with other real estate speculation, led to a severe threat to arable land in

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<sup>90</sup> Deheng 2006.

<sup>91</sup> Cartier 2001.

<sup>92</sup> Huang and Yang 1996.

<sup>93</sup> *Ibid.*

<sup>94</sup> Cartier 2001.

the country. Between 1986 and 1995 approximately 5 million hectares of arable land were transferred to infrastructure and real estate development<sup>95</sup>. Between 1990 and 1997, more than 350,000 hectares of arable land were transferred to industry in Fujian province, site of the Xiamen SEZ, and per capita land availability in Fujian dropped to 0.038 ha per capita, the lowest nationwide<sup>96</sup>. Meanwhile, areas with a shortage of arable land began reducing the term of the land use contracts granted to families, and the threat of requisition by the state in areas near SEZ's or cities led many farmers to reduce their investment in maintaining the land.

This spiralling threat to agricultural production and people's livelihoods led to increasing national concern on this matter. By 1997 the central government was so alarmed that it imposed a blanket moratorium on conversion of land use across the country, and in 1998 a new law was passed with an emphasis on restricting conversion of agricultural land. The chairman of the Environmental and Resources Protection Committee of the National Peoples' Congress characterized the new law as the "strictest land law in the world"<sup>97</sup>. Meanwhile, the rampant real estate speculation led to bankruptcies and financial crises among some of China's biggest public sector corporations. Of the three major bankruptcies, two were of the investment corporations attached to provincial governments with large SEZ's – namely Guangdong and, as mentioned earlier, Hainan<sup>98</sup>. These bankruptcies posed a serious threat to the Chinese economy and macroeconomic stability.

As Cartier (2001) puts it, "The SEZ concept promoted land development without directly addressing impacts on cultivable land and the natural resource base." The lessons from this experience are sobering for India, where "zone fever" has already begun.

### *Labour Abuse and Social Violence*

In addition to real estate speculation, the institutions of zones in China also produced other problems. In an ironic situation for an avowedly communist regime, abuse of labour is extreme and rampant in Chinese SEZ's<sup>99</sup>. Seven million people out of Shenzhen's total population of twelve million are migrant workers<sup>100</sup>, drawn in by the rapid industrialisation of the city. Legal protections and job security for these workers are almost non-existent. Wages are low and often unpaid: in 2003, at least

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<sup>95</sup> Cartier 2001.

<sup>96</sup> *Ibid.*

<sup>97</sup> *Ibid.*

<sup>98</sup> *Ibid.*

<sup>99</sup> ICFTU 2003.

<sup>100</sup> French 2006.

half the firms in Shenzhen owed their employees wage arrears<sup>101</sup>, and at least one third of workers in Chinese zones receive less than the minimum wage<sup>102</sup>. The labour turnover rate is more than 10% as workers leave their jobs or are forced to leave with great frequency<sup>103</sup>. In 1992, official data shows that 836 workers died in industrial accidents in Guangdong province, the home of Shenzhen – a 63% increase over the previous year<sup>104</sup>. The same province has more than 5,00,000 child labourers, a phenomenon that had greatly decreased in post-revolutionary China<sup>105</sup>. Indeed, the desperation of the situation can be seen by the fact that, despite the fact that strikes are essentially illegal in Shenzhen and no independent trade unions exist, more than 10,000 wildcat strikes took place in 2006 alone<sup>106</sup>.

Large-scale migration of workers, insecurity of employment and low wages are also accompanied, unsurprisingly, by a steep rise in crime. Shenzhen now has a crime rate nine times higher than Shanghai<sup>107</sup>. In 1995, the *Economist* reported that, in Shenzhen, “Triads [Hong Kong-based mafias] fight gun battles with the police over jurisdictional turf.” Relaxed customs and policing arrangements have also led to large-scale smuggling; out of the four original zones, two have recently been hit by major smuggling scams. In 2000 a four billion dollar export tax fraud was uncovered in Shantou<sup>108</sup>, while in 1999 it was found that a smuggling ring had been operating in Xiamen from 1996 and had smuggled out goods worth more than 6.4 billion dollars<sup>109</sup>.

Thus the overall picture that this presents is of a degradation of political institutions meant to regulate social activity and protect, or at least represent, the interests of the working class and the poor. Furthermore, the size of Chinese SEZ's means that these structures extend over an area that includes not just the actual workers of SEZ enterprises but an entire city-size population (in the case of Shenzhen, as noted above, covering 12 million people). The problems of EPZ's in general – particularly the labour and political regime they generate - are thus magnified into what can only be seen as an institutional crisis. This should be a salutary lesson for those in India who see multi product SEZ's as shining future “company towns”<sup>110</sup>.

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<sup>101</sup> ICFTU 2003.

<sup>102</sup> Jayanthakumaran 2003.

<sup>103</sup> French 2006.

<sup>104</sup> Weil 1996.

<sup>105</sup> Weil 1996.

<sup>106</sup> French 2006.

<sup>107</sup> Goswami 2007.

<sup>108</sup> *Business China* 2006.

<sup>109</sup> *People's Daily* 2000.

<sup>110</sup> See for instance Chakraverti 2006.

## *Responses and Reactions*

The events in China's SEZ's in the 1990's - "zone fever", smuggling, distortions in development towards the coastal areas – led to growing concern within China's ruling groups as well. In 1994, a prominent Chinese academic called for the abolition of SEZ's because "SEZs have fostered a privileged clique contending for benefit with the central authorities. Politically, they ask for special policies to be offered by the central authorities and, economically, they bribe Beijing officials"<sup>111</sup>. The concern culminated in an announcement by Chairman Li Peng in 1996 that, within five years, foreign and domestic investors would no longer be able to import materials duty free nor enjoy such unusually low tax rates<sup>112</sup>. In a context where China's overall economy continues to liberalise, this announcement was understood by Reardon (1996) as "taking the 'special' out of special economic zones." It should however be noted that many such announcements were never implemented because of the growing power of foreign investors in Chinese economic management<sup>113</sup>.

Thus, the common impression of Chinese SEZ's as stellar successes was not shared by significant sections of the Chinese leadership themselves. The zones appear to dazzle with huge amounts of foreign investment and technological booms; but they also have a dark side that is rarely acknowledged. Moreover, the events described above are occurring in a society that had made great strides – particularly compared to India – in providing security of health, shelter and livelihood to great sections of its population. Child labour, distress migration and begging, all common features in SEZ's and coastal provinces, were phenomena that had almost vanished in the decades after the revolution<sup>114</sup>. What is happening in SEZ's can be seen as progress, therefore, only insofar as aggregate investment is concerned; but socially it is difficult to see it as anything other than a regression<sup>115</sup>.

There is perhaps no better demonstration of the politics of SEZ policies. The policy shift that made SEZ's into 'vanguards of liberalisation' also made their institutions, already authoritarian under one party rule, into powerful instruments of speculative finance capital and big industry. The 'tilt' of institutions in favour of investor capital has severely undermined the ability of the political system to regulate such capital. This gradual degradation of political systems has assumed a very concrete and

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<sup>111</sup> As cited in Reardon 1996.

<sup>112</sup> Reardon 1996.

<sup>113</sup> Weil 1996.

<sup>114</sup> Weil 1996.

<sup>115</sup> A far more extensive argument on the social and political impacts of market socialism, of which SEZs are the best example, is presented in Weil 1996.



physical manifestation in the territory of SEZ's. On the one hand this leads to the rampant real estate speculation that has harmed the SEZ's effectiveness as a tool even within the narrow parameters of economic success. On the other, the affected population finds itself lacking a political system that is responsive to its rights and concerns. On a national scale, the Chinese government is forced to face the ripple effects of this political reality in the form of loss of arable land, smuggling and increasing unrest and migration.

Perhaps the best way of summing up this tale is to quote a statement by a senior Chinese academic, Zhao Xiao, a former adviser to the State Council: “This path is now a dead end... Governments can't count on the beauty of investment covering up 100 other kinds of ugliness.”<sup>116</sup>

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<sup>116</sup> French 2006

This chapter, the last of Part I of this study, brings us finally to the Indian experience with EPZ's and SEZ's. India's – and indeed Asia's - first Export Processing Zone was set up in Kandla, Gujarat, in 1965. In the four decades since, the EPZ programme has grown from one zone, to seven, to 53 approved SEZ's under the previous policy, to the current total of more than 400 approved so far under the SEZ Act. India has had no shortage of experience with zone policies.

Yet, despite this long track record, until the SEZ Act was passed in 2005, India's EPZ policy was adjudged by most commentators as a failure<sup>117</sup>. Export performance and investment levels have generally been dismal. Politically, in sharp contrast to many of the other Asian countries reviewed in chapter 2 above, in India EPZ's seem to never have been a central part of either the export or the industrialisation strategy of the government. EPZ's tended to be treated as incidental, following the broad policies of the rest of the country rather than attempting major transformations. The SEZ Act is that it marks the first time that this has changed.

This theme runs throughout the history of India's EPZ's, which this chapter summarises before sketching the politics of the EPZ policy.

### ***A History of India's EPZ's***

#### *The Stagnant Decades: 1965 – 1990*

The Kandla zone remained India's only EPZ until 1973, when it was joined by the Santa Cruz EPZ (SEEPZ). In these initial years, the zone policies were unclear. Overall policies were applied to the zones as well with only small modifications; clearance regulations requiring multiple department clearances continued, customs regulations were tight and FDI was restricted. The major concessions that were provided were tax concessions and infrastructural facilities. However, exports from these zones remained an insignificant part of India's overall exports up to the late 1970's, and foreign investment as well remained very low<sup>118</sup>. However, from 1975 to 1985, as production in the SEEPZ rose, there was more rapid growth in exports, and by 1985 the share of EPZ's in India's exports had risen to 3% and 4.4% of total and manufactured exports respectively. Foreign exchange also began to

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<sup>117</sup> See for instance Khatri 2001, Aggarwal 2004.

<sup>118</sup> Amirahmadi and Wu 1995.

rise at a higher rate<sup>119</sup>.

In 1984, four new zones were set up in Noida (Uttar Pradesh), Falta (West Bengal), Cochin (Kerala) and Chennai (Tamil Nadu). This expansion of the EPZ's perhaps reflected a general turn towards a more “pro-business” climate under Indira Gandhi and Rajiv Gandhi, but it was not accompanied by significant change in the laws and policies that governed them. Moreover, and surprisingly, the expansion of the EPZ's had little effect on the share of zones in total exports<sup>120</sup>. This continued to grow, but at a slower rate than in the preceding decade. In 1989, the final 'traditional' zone was set up at Vishakhapatnam.

The effect of these zones was relatively small, as noted earlier. The overall area of the zones remained quite small as well, as shown in this table<sup>121</sup>:

	Kandla	Santa Cruz	Cochin	Falta	Chennai	Noida	Vishakhapatnam
Size of the zone (acres)	700	93	103	280	261	310	360

Thus, none of these zones was large enough to be considered a “multi-product” zone under today's SEZ Act, and only one – Kandla – was significantly larger than the minimum 100 hectares area prescribed as the minimum for a single sector zone.

Most exports were directed at the Soviet Union and the Eastern European countries, and the focus areas were engineering goods and drugs, with electronics and textiles being lower in proportion<sup>122</sup>. In a parallel to the experience of Sri Lanka and other nations with the Multi Fibre Arrangement, this focus on Eastern Europe reflected access to guaranteed open markets there. Employment levels also remained low, at approximately 35,205 workers – or 5800 per zone – in 1990<sup>123</sup>.

#### *Regulatory Change Post Liberalisation: 1990 - 2000*

After liberalisation began in 1991, rapid changes also began to affect the EPZ's, in keeping with the trend noted above of EPZ policy following rather than leading national policies. A series of orders were passed delegating more powers to zonal authorities, providing additional incentives and

<sup>119</sup> Aggarwal 2004.

<sup>120</sup> *Ibid.*

<sup>121</sup> Table drawn from Aggarwal 2004.

<sup>122</sup> Aggarwal 2005.

<sup>123</sup> Aggarwal 2004.

simplifying procedures, and providing additional infrastructure<sup>124</sup>. It should be noted however that despite these simplifications, even in 2004 EPZ units complained that they had to deal with up to 15 government departments at the time of entry and up to 13 during day to day functioning<sup>125</sup>.

Yet these changes appeared to still have little effect on EPZ performance. During this period, exports grew on an average of 24.4% annually, which may seem a high growth rate but was in fact considerably less than the preceding decades; similarly, employment growth also slowed considerably<sup>126</sup>. The only index that appears to show an impact of these new policies is what Aggarwal (2004) calculates a proxy for productivity, namely the amount of exports generated per employee; this grew faster around the early 1990's, but then returned to its earlier growth rate. Foreign exchange earnings remained low at approximately \$1.04 billion in 1998 (notably, far less than the revenue lost by customs exemptions, which was \$1.67 billion)<sup>127</sup>.

Moreover, two other indices – value addition and foreign investment – show even more disturbing results. It should be noted that in terms of benefit to the economy, these are perhaps the two most important indices, given that employment contributions of EPZ's were negligible. Aggarwal (2004) finds that value addition in India's EPZ's had a trend growth rate of 1.5% overall, which is not statistically different from zero; the only redeeming feature is that the average value addition in Indian EPZ's has been around 38%, which is higher than the rates reported for several other Asian nations (seeChapter 2).

It is striking however that foreign investment, one of the biggest justifications for EPZ's, remained uncannily constant. Thus Amirahmadi and Wu (1995) report that FDI formed 16.7% of investment in the EPZ's in 1983, and Khatri (2001) reports a figure of 17% in 2000. In short, even as zones multiplied and expanded, foreign investment stayed at a constant and low proportion of investment. A significant rise in the FDI proportion only took place after 2000.

During this period, this overall picture of constancy notwithstanding, there was a significant shift in the sectoral composition of EPZ industries and exports. The collapse of the Soviet Union brought the protected markets for engineering goods and drugs to an end. Both these sectors showed a sharp decline between 1990 and 2002, from 27% to 5% and 26% to 6% of EPZ exports for engineering goods and pharmaceuticals respectively<sup>128</sup>. Their place was taken by the electronics and gems

<sup>124</sup> CII 2006.

<sup>125</sup> Aggarwal 2004.

<sup>126</sup> *Ibid.*

<sup>127</sup> Citizens' Research Centre 2007.

<sup>128</sup> CII 2006.

### *Export Oriented Units*

During the 1990's the Export Oriented Units scheme was also introduced, which provided similar incentives to the EPZ's but removed the geographical need for the unit to be inside a "zone." This scheme did particularly well and the share in exports of EOU's rose from 2.14% to 8.08% between 1990 and 1998 (Khatri 2001). By 2001, the figure was approximately 13%, three times higher than EPZ's/SEZ's, which were producing 4.1% of India's exports (Indiastat.com 2007, Aggarwal 2004). The EOU's also tended to be more intensive in their use of domestic raw materials and hence had more linkages with the domestic economy. After 2001, the EOU incentive package became very similar to that provided to SEZ's in the current Act.

The provision for EOU's to function anywhere in the country made them far easier to set up. It also removed many of the potential negative consequences of geographical zones, particularly real estate speculation. However, EOU's also have their share of problems, being dogged by accusations of tax evasion and fraud. The 33<sup>rd</sup> Report of the Parliamentary Standing Committee on Finance found that show cause notices had been issued for more than Rs. 3,400 crores between 2002-2003 and 2004-2005 for fraud in EOU's and some other export schemes. Evasion in the EOU's involves fraudulent accounts, diversion of goods into the domestic tariff area, and similar activities (CITU 2006). As a result, the Standing Committee had recommended that all export incentive schemes should be reviewed.

The EOU scheme does however provides an interesting point of comparison with respect to SEZ's, whose maximum export contribution would still be less than the 13% share of EOU's (see chapter 6). Clearly a geographical zone is not necessary for export performance.

manufacturing sectors, which in 2002 formed 34% and 42% of exports respectively<sup>129</sup>. It should be noted that more than 50% of the "electronics" exports were software<sup>130</sup>.

### *The New SEZ Policy*

In 1997, the new Export Import Policy declared that from April 1, 2000, a new scheme would be put in place to revamp EPZ's. This was the Special Economic Zone policy, intended to consolidate and promote EPZ's in a more integrated manner than before. It also marked the beginning of a shift towards seeing EPZ's and SEZ's as distinct elements in India's export policy.

Many of the features of the current SEZ Act were brought in through this policy, including the notion of "multi-product" and "single product" SEZ's and minimum areas for each. Private sector SEZ's were also allowed for the first time; prior to this, all zones were set up by the State governments. Incentives were greatly increased, and both SEZ units and developers were provided duty free imports

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<sup>129</sup> *Ibid.*

<sup>130</sup> Aggarwal 2004.

of raw materials and capital goods<sup>131</sup>. Further powers were delegated to the Development Commissioner, including the authority to serve as the Labour Commissioner for the zones<sup>132</sup>. The structure of overall governance was reduced to a three tier system, with the EPZ cell in the Ministry of Commerce at the top, followed by a Board of Approvals at the Centre which would decide on units' applications to locate into SEZ's, and finally the Development Commissioners of the zones themselves. Regulations on foreign investment were greatly eased.

The old EPZ's were all converted to SEZ's under the new policy over the next few years. A number of new SEZ's were also declared under the policy, with approximately 53 approved by June 2005, most of which had not begun operating when the SEZ Act was passed<sup>133</sup>. State governments were also encouraged to prepare their own SEZ laws and regulations, and a number of them did so<sup>134</sup>.

Yet it was still felt that the new policy had not introduced “significant” changes. As stated above, in 2004 EPZ / SEZ units were still critical of the complexities of approvals and clearances in the SEZ's. Aggarwal (2004) criticised the new policy for failing to decentralise approvals and instead centralising them further. Describing the draft SEZ Bill 2004, which extended the SEZ policy, she states that “This scheme will not go far. It needs a complete re-orientation for achieving success.”

The results of the new policy seemed, moreover, to be something of a contradictory mix. The share of foreign investment grew for the first time since the 1980's. By 2003, the proportion of FDI had risen to 24.3%<sup>135</sup>, still low by international standards but higher than the previous level. Overall investment in SEZ's also showed a sharp rise from 980.7 crores in 1998 to 1700 crores in 2003, a growth of nearly 73%<sup>136</sup>.

But the output of the EPZ's continued its stagnation, and exports grew by an average of only 7% per year between 2000 and 2003<sup>137</sup>, while sectoral diversity declined<sup>138</sup>. Employment growth was markedly out of step with investment growth, and the workforce in SEZ's grew by only 13.7% between 1998 and 2003<sup>139</sup>. This reflected a sharp shift towards more capital intensity in SEZ's, leading in turn to

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<sup>131</sup> See customs notifications 39/2002 Central Excise and 82/2002 Customs, both dated 13.8.2002, for developers, and 52/2000-CE and 137/2000-Cus, both dated 19.10.2000, for units.

<sup>132</sup> CII 2006.

<sup>133</sup> CII 2006.

<sup>134</sup> .See [www.sezindia.nic.in](http://www.sezindia.nic.in) and discussion in next chapter.

<sup>135</sup> Aggarwal 2004.

<sup>136</sup> CII 2006.

<sup>137</sup> Aggarwal 2004.

<sup>138</sup> Aggarwal 2005.

<sup>139</sup> CII 2006.

a decline in “export productivity” per worker<sup>140</sup>. Finally, even with the additional investment, in the three zones for which data is available – Kandla, Falta and Santa Cruz – in 2002 the number of units in the SEZ remained less than half of the expected capacity<sup>141</sup>.

These somewhat contradictory results have one common theme, however. After three and a half decades of gradualist change in India's EPZ's and economic failure of the zones, the pace of change began accelerating after 2000. This was the beginning of the process that culminated in the SEZ Act.

### ***The Politics of Policy and the Success of EPZ's***

One key factor identified earlier in SEZ policies is the balance of power between investors and the State in policy-making. On this, there is an unusually rich source of data on South Asian EPZ policy in the form of the detailed comparative analysis of Indian, Bangladeshi and Sri Lankan EPZ's by Aggarwal (2005). In addition to other arguments, she presents two sets of data: a survey of business owners and a regression analysis, based on export levels and FDI, of the 'performance' of EPZ's in India, Sri Lanka and Bangladesh. She focuses on reading this data directly as indicators for policy; but, if the data is read somewhat differently, it provides very interesting insights into the South Asian EPZ story.

The survey of business owners covered 257 business owners in all the zones in India, 22 owners in three zones in Sri Lanka and 12 in two zones in Bangladesh. The purpose of the survey was to identify the primary objections of business owners to the current structure of Indian EPZ's and SEZ's. Her conclusions, in summary, are as follows. While “all the four sets of factors, namely better location, infrastructure, governance and an attractive incentive package are rated almost equally important in determining the attractiveness of the zones”, there are variations within these factors. In particular, the following emerge as key:

- Within location factors, proximity to cities and ports are regarded as most important, even more than proximity to industrial clusters or to developed regions in general;
- Among factor costs, costs of labour and real estate were regarded as most important, more so than costs of raw materials (arguably, Aggarwal claims, because most raw materials are

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<sup>140</sup> Aggarwal 2005.

<sup>141</sup> Aggarwal 2004.

imported);

- Relaxation of labour laws emerged as a major factor;
- Among regulatory requirements other than labour laws, single window clearance and faster customs clearances were regarded as the most important requirements.

The findings of Aggarwal's regression analysis both complement and, in an interesting way, contradict these results. The regression is done in two sets, one on the amount of investment into the zones and one on export performance, and is further broken up into two levels of comparison – at the country level and at the zonal level.

When comparing between the three countries, investment in the zones is found to be correlated with the relative advantages of the zones over the rest of the country in terms of infrastructure, 'governance' and concessions offered, as might be predicted by the business owners' survey<sup>142</sup>. The significance is greater for those variables that measure *relative* advantages of the zones rather than those that seek absolute measures; in short, zones compete not with other countries but with other parts of their own country for investment. Strikingly, however, few of these factors seemed to matter when it came to the country-level export performance of zones. The only factors that emerged as significant in this context were those variables measuring overall 'governance' and overall infrastructure of the countries concerned. The zones' own characteristics were, in short, irrelevant.

The zone level analysis also produces interesting results. As expected, when it comes to investment levels in zones, location is significantly correlated with investment, but regional development is as well – contrary to the opinion of the business owners. Further, the size of the zone – a frequent criticism of Indian EPZ's and SEZ's – emerges as insignificant. But once again the data for export performance of zones shows somewhat different findings. Size remains insignificant, but regional development, capital intensity and the concentration of a zone on a single industry emerge as the significant factors.

This is a very mixed bag of results. What does it mean, particularly in light of the experiences of Indian EPZ's and those of the world outlined in previous chapters? It should be noted in this context that it is fair to take export performance as a proxy for the general 'success' of zones, since South Asian zones lack technology transfer, backward linkages or significant employment

<sup>142</sup> Wage levels were found to be insignificant, a finding that is probably due to the fact that Aggarwal assumed that official minimum wages reflect wage levels in the three countries – while, as noted below, in reality minimum wages have little relationship to the wages actually paid.



contributions (except perhaps in Bangladesh), making exports the main contribution of such zones to the concerned economies.

A rough method of engaging with this is to divide up the various factors that Aggarwal identifies for her regression analysis into two categories. There are some factors that are *investor-driven*, in the sense that they are generally determined by the ability of investors to request or pressure the government into policy changes in order to make zones 'attractive.' There are others that are *state driven*, namely shaped by the overall policy approach of the government. We can tentatively divide the factors into these two categories as follows:

<i>Investor Driven</i>	<i>State Driven</i>
<ul style="list-style-type: none"> <li>● Relaxation of clearances and labour laws</li> <li>● Tax incentives</li> <li>● Different governance systems in zones</li> <li>● Lower wages</li> <li>● Infrastructure provisions and size</li> </ul>	<ul style="list-style-type: none"> <li>● Overall development</li> <li>● Overall infrastructure</li> <li>● Capital intensity in zones</li> <li>● Sectoral composition of investment in zones</li> <li>● Regional development of zone areas</li> </ul>

One overlapping factor is the location of zones, which may be determined partly by investor factors and partly by the state's overall strategy.

Divided in this fashion, the factors on the left – investor driven factors – are to some extent found by Aggarwal to be relevant to attracting investment to zones, with the caveat that the point of comparison is not with other countries but with the country itself. But when it comes to export performance, the main *raison d'etre* of the zones themselves, it is the factors on the right that emerge as important, while those on the left dwindle to insignificance.

Thus, aiming to satisfy investors' demands has in fact little effect on export performance. It may draw more investment, but that investment makes less contribution to the economy. This is a straightforward demonstration of the pattern discussed in the earlier chapters – namely, the power balance in an EPZ policy is crucial not only for the sociopolitical impact of zones but for their economic success as well. Yet India's SEZ policy has evolved in exactly the opposite direction.

## *Institutions in Indian Zones*

India's EPZ's, with their small size and relative lack of importance in the country's economy, have not demonstrated the kind of markedly new or different sociopolitical phenomena that their cousins in other countries have. But nevertheless, the conditions of labour once again provide an indicator of the political structures at work.

The story of workers' rights in EPZ's in India sounds depressingly familiar. A 1993 study by the National Labour Institute in the SEEPZ found that the workforce mostly consisted of women younger than 25, in an exact parallel to the workforce of other Asian EPZ's<sup>143</sup>. Abuses of workers were rife, and patterns described in chapter 2 repeated themselves in India – such as harassment of workers once they became pregnant, frequent breaks in service to prevent workers claiming permanent or regular status and payments below minimum wages. Though technically labour laws applied in the zone, their enforcement was abysmal<sup>144</sup>. In the NOIDA EPZ, reported violations of workers' rights included summary dismissal for demanding enforcement of labour laws<sup>145</sup>. In 2002, at an All India EPZ / SEZ Workers Convention organised by the Centre for Indian Trade Unions (CITU), workers reported the following abuses<sup>146</sup>:

Appointment letters, pay slips, are not given. Minimum wages are not implemented. Workers are employed on contract basis. Overtime is compulsory but overtime wages are not paid. On the other hand, wages are deducted if the workers fail to meet the high production targets fixed unilaterally by the employers. Safety equipment/ apparels are not provided, as that would increase production costs and reduce the speed and output. Women are made to work in night shifts without providing proper conveyance to their residences. They are not given maternity leave. On the other hand, women found to be pregnant are removed from service. Crèches are not provided. Young and unmarried women are only preferred. The use of toilets is controlled by issuing tokens. Sexual harassment is very common.

It might be argued that this state of affairs applies across India, where labour laws are more often honoured in the breach, even in the so-called organised sector. But there were certain features that were specific to zones. Workers were told that they could not organise trade unions because of the “zone” status<sup>147</sup>. Governments also went out of their way to reduce labour rights protections. Factories in zones were declared public utility services, a designation under the Industrial Disputes Act, 1947,

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<sup>143</sup> Madhok 2000.

<sup>144</sup> Madhok 2000.

<sup>145</sup> ICFTU 2003.

<sup>146</sup> Hemalatha 2002.

<sup>147</sup> Madhok 2000.

which bars strikes in such services<sup>148</sup>. The Commerce Ministry reportedly issued orders that labour inspectors cannot visit the zones without prior permission from the Ministry<sup>149</sup>. In a parallel to the situation elsewhere, the geographical limits of the zone territory exacerbated violation of workers' rights. Heavy security makes it impossible for outsiders to enter, and in several studies researchers were forced to meet workers in their homes<sup>150</sup>. Workers within zones are often forbidden to talk to outsiders or even to each other<sup>151</sup>.

In short, vulnerability levels within zones are very high. The pattern is familiar to us from other countries, and the regime of labour that applies in those EPZ's appears to apply with only a few modifications to the Indian situation. Regardless of the law, the ability of workers to organise or to demand their rights is extremely constrained.

We can gain a more interesting perspective into how this system works by citing some results from an earlier version of the survey of EPZ business owners cited above<sup>152</sup> (this version of the survey was limited to India), which provides some insight into the perspective of capital within the zones. In the survey, more than 62% of business owners described the labour laws as “highly stringent”, a statement that the workers in the zones – in light of the discussion above – would presumably find surprising. Their responses to individual labour laws present an even more interesting story<sup>153</sup>:

#### Responses of Business Owners to Labour Laws

	<i>Not Constraining</i>	<i>Average</i>	<i>Highly Constraining</i>
Minimum Wages Act	16.7%	31.5%	51.8%
Factories Act	9.9%	27.9%	62.2%
Equal Remuneration Act	23.2%	35.5%	41.2%
Contract Labour (Regulation & Abolition) Act	16.1%	30.2%	53.7%

<sup>148</sup> Aggarwal 2004.

<sup>149</sup> Hemalatha 2002.

<sup>150</sup> Madhok 2000.

<sup>151</sup> Hemalatha 2002.

<sup>152</sup> Aggarwal 2004.

<sup>153</sup> Table reproduced from Aggarwal 2004.

	<i>Not Constraining</i>	<i>Average</i>	<i>Highly Constraining</i>
Industrial Disputes Act	14.0%	26.0%	60.0%
Workmen Compensation Act	16.4%	35.3%	48.3%
Industrial Employment Act	25.2%	33.3%	41.5%
Trade Unions Act	19.4%	26.4%	54.2%
Social Security Act	19.4%	28.0%	52.6%

In short, all labour laws are found “highly constraining” by at least a plurality of the owners, and in most cases the majority. But it is interesting to note that the Acts that are almost certainly the most violated – the Minimum Wages Act and the Contract Labour (Regulation and Abolition) Act – are not the ones that earn the most opprobrium. Rather, it is the Factories Act and the Industrial Disputes Act, the central workplace Acts that define the conditions of the workplace and the method of resolution of disputes, which emerge as the most “constraining.” Further, the element of these laws that is commonly subject to the most criticism, namely the restriction on retrenchment of workers, is not in fact objected to by most business owners: when asked whether it is difficult to fire labour in the zones, 46% of the owners, a plurality, said this was not the case.

What is the origin of these seemingly contradictory responses? Another finding of the survey sheds a little more light. When asked about the effectiveness of declaring zones to be public utility services – i.e. effectively ending the threat of strikes – less than one third of the surveyed business owners found this measure to be effective in reducing the “constraints” of labour law. But more than 60% supported the idea of delegating the powers of the Labour Commissioner to the Development Commissioner, a policy that was put in place after 2000 and is retained by the current SEZ Rules.

Read together, a consistent theme emerges from all these responses. In an ironic sense the responses of the employers confirm the dismal situation of workers as reported above. If workers were actually receiving their rights, then legal provisions like the Minimum Wages Act, the Contract Labour (Regulation and Abolition) Act and the right to strike would have much greater importance to business owners. But where such rights are being violated with impunity, it is not the letter of the law that matters; it is the extent to which legal structures that “interfere” with operations can be further undermined (removing in the process whatever little space for workers' struggles exists). And for this,

***“Rigid Labour Markets” = Apparently Higher Productivity?***

For several years now there has been persistent criticism of Indian labour laws on the grounds that they “lower productivity.” But, in the context of workers' rights, a striking statistic can be found in the comparative study by Aggarwal (2005). Despite supposedly “highly stringent” labour laws and “labour market rigidities”, the productivity of the Indian EPZ workforce, measured in terms of export units per worker, was *higher* than that of EPZ workers in Sri Lanka and Bangladesh and consistently remained so until 2000. In those two countries, labour laws are greatly relaxed in EPZ's, and they are cited by Indian employers as better labour law regimes. This figure in itself should serve to generate a great deal of skepticism about claims of “rigid labour markets.”

it is necessary that those structures either be destroyed – by exempting zones from labour law, the preeminent demand of the concerned employers – or at the least brought to a level and an institution that investors can more easily control. Hence the desire that such powers be delegated to the Development Commissioner, and the fact that this is seen as far more effective than a nullification of the right to strike, which in any case cannot be exercised.

It is this that lies at the root of the seemingly contradictory responses of business owners to labour laws and labour regulation. Owners see zones as areas of institutional governance that should come under their control, a clear demonstration of the fact that zones are seen as tools of capital – not institutions of regulation. Finally, one should note that – investors' sentiments notwithstanding – labour law appears to have little to do with export performance in South Asia, with Indian workers having higher productivity levels than their counterparts in other countries (see box).

### ***Conclusions***

What does this exploration tell us about Indian EPZ's and their history? Until the SEZ Act, zones did not form a major part of India's economic history. Even their low economic impacts, however, echo the experience of other Asian countries (without many of their positive features). But of more interest than this history of economic failure is the political realities that were discussed above. Indian and South Asian EPZ's provide a striking example of how investor dominance over policy and institutions is neither economically positive nor sociopolitically effective. Yet it is precisely this growing dominance that has reached its culmination in the current SEZ policy and Act, which we turn to in Part II of this study.

## A SUMMARY OF EXPERIENCES

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The three previous chapters provide an overall historical frame for examining the SEZ policy. In particular, three points seem to emerge:

- *A power shift in favour of investors may reduce economic gains.*

Accepting investors' demands as the main basis of policy-making appears to have little effect on economic impacts (in the South Asian experience) and is contrary to the historical experience of South Korea and Taiwan. A conscious and firm state perspective on economic planning appears more conducive to economic gains.

- *The enhanced power of capital in the special institutional regimes for zones tends to cause severe social and economic consequences.*

Supporters of zone policies tend to dismiss concerns about zone administration as “populist”, claiming that social consequences – and violation of workers' rights in particular - is the 'price' the 'country' must pay for investment (and such employment is in any case 'better' than the unorganised sector). But the creation of this institutional regime is bad both for workers *and* for the economy, with real estate speculation and smuggling being the other side of the coin of a “pro-business” administration. Control over resources tends to shift towards institutions that are closely allied with industrial and speculative capital, violating people's rights and negating economic gains.

- *The political and economic effects of zones can generate problems for society as a whole.*

The problems of zones in turn cause damage to other parts of the economy as well, with China being the best example. The economic failures of zones, such as concentration of exports in a few sectors and the encouragement of dependence on a handful of 'footloose' industries, increase overall macroeconomic vulnerability. In the Chinese case, the overall tilt of political institutions both within and outside the zones towards zone-style policies – and investment capital generally – created a macroeconomic crisis and severe social consequences.

*PART II: THE SEZ ACT AND  
THE FUTURE*

## CHAPTER V: THE SEZ ACT AND RULES

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The stated purpose of passing the Special Economic Zones Act in 2005 was, *inter alia*, to provide a uniform framework for the creation of SEZ's / EPZ's in the country. This was done through the Act itself, the Special Economic Zones Rules, 2006 and a few other relevant legal instruments. This chapter details the provisions of these legislations, as well as noting some provisions of State SEZ policies and Central government's "model SEZ policy", which were mostly drafted under the previous SEZ policy but presumably will form the foundation for the States' policies in the new regime as well. It should be noted in this context that the Act is the supreme legislation, and can only be modified by an amendment of Parliament, but all other policies or the Rules can be modified through a notification of the Central or State governments. Therefore, particularly in the current context of rapid policy changes, these specifications are very likely to be altered, and indeed have reportedly just been changed again as this study is going to print<sup>154</sup>.

This chapter does not follow the order of the sections in the legislations, but instead covers six topic areas: the declaration of SEZ's, the operations inside SEZ's, provisions relating to taxes and other fiscal incentives, other concessional schemes and regulatory instruments, and provisions relating to institutions of governance in the zones.

### ***Applying For and Declaring Special Economic Zones***

Who can create a Special Economic Zone and how is this to be done? The Act provides that the Central government, the State government or any 'person' (implying any company) may create an SEZ or a Free Trade and Warehousing Zone<sup>155</sup>. This government or company is known as the Developer. In case a company wishes to create an SEZ, it may apply either to the State or directly to the Board of Approvals at the Centre, but in the latter case the State government must later be consulted. A State government applies to the Board of Approvals directly, while the Central government may set up a zone without going to the Board but only with after consulting the State government concerned<sup>156</sup>. The

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<sup>154</sup> News reports indicate that a meeting of the Empowered Group of Ministers on SEZ's on April 5<sup>th</sup>, 2007, has decided on a number of changes to the SEZ Rules. These are noted in footnotes in this chapter, as it is not clear when and how they will be implemented. The recommendations are also discussed in chapter 7.

<sup>155</sup> Section 3(1) of the Special Economic Zones Act, 2005 (henceforth the "Act").

<sup>156</sup> Sections 3(2) – 3(4) of the Act.



State governments are required to forward private proposals to the Board of Approvals within 45 days of receiving them (the State government apparently does not have the power to reject proposals itself)<sup>157</sup>, though, as said above, an applicant can apply directly to the Board of Approvals as well.

All applications except those of the Central government thus go before the Central body known as the Board of Approvals, which consists of the following members<sup>158</sup>:

- Additional Secretary (or higher rank) in the Ministry of Commerce – Chairperson;
- Two Joint Secretaries (or higher rank officers) from the department concerned with Revenue;
- Joint Secretary (or higher rank) from the Ministry of Finance;
- Up to 10 officers representing Ministries of Commerce, Industrial Policy and Promotion, Science and Technology, Small Scale Industries and agro and rural industries, Home Affairs, Defence, Environment and Forests, Law, Overseas Indian Affairs and Urban Development;
- A nominee of the concerned State government;
- Director General of Foreign Trade;
- Development Commissioner (in case of applications for units in a zone);
- A professor of one of the Indian Institutes of Management;
- Deputy Secretary (or higher rank) from the Department dealing with Special Economic Zones – Member-Secretary.

This body therefore consists almost entirely of government officials dealing with commerce and finance, with the only non-official member being a professor from a management institution.

When approving the proposal, the Board is required to ensure that it satisfies the minimum requirements for the various types of SEZ, which are the following:

<i>Type of Special Economic Zone</i>	<i>Requirements</i>
Multi-Product <sup>159</sup>	<ul style="list-style-type: none"> <li>● At least 1000 hectares of contiguous area, relaxed to 200 hectares for some States<sup>160</sup></li> <li>● At least 35% of this area must be</li> </ul>

<sup>157</sup> Rule 4 of the Special Economic Zones Rules, 2006 (henceforth the “Rules”).

<sup>158</sup> Section 8(2) of the Act.

<sup>159</sup> Rule 5(2)(a) of the Rules.

<sup>160</sup> Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Manipur, Tripura, Himachal Pradesh, Uttaranchal, Sikkim, Jammu and Kashmir, Goa and Union Territories.

<i>Type of Special Economic Zone</i>	<i>Requirements</i>
	earmarked as a “processing area”, which can be relaxed to 25% by the Central government <sup>161</sup>
Multi-Product (Services) <sup>162</sup> ( <i>no longer valid</i> )	At least 100 hectares of contiguous area; <i>Rest as above.</i>  <i>Note that this clause was removed by the March 2007 amendment to the Rules, and services SEZ's instead covered under the next category.</i>
Single-Sector <sup>163</sup> (or in a port / airport, or for “one or more services” <sup>164</sup> )	<ul style="list-style-type: none"> <li>● At least 100 hectares of contiguous area, relaxed to fifty hectares for some States<sup>165</sup></li> <li>● 50% processing area</li> </ul>
Single-Sector for IT, bio-technology, alternative energy or gems and jewellery <sup>166</sup>	<ul style="list-style-type: none"> <li>● At least 10 hectares of contiguous area</li> <li>● At least one lakh sq. m of built up processing area for IT zones, 40,000 sq m for biotech and alternative energy zones, and 50,000 sq m for gems zones</li> <li>● In all cases at least 50% for processing area</li> </ul>
Free Trade and Warehousing Zone <sup>167</sup>	<ul style="list-style-type: none"> <li>● At least 40 hectares of contiguous area, except when part of a single sector SEZ, in which case cannot be more than 20% of processing area;</li> <li>● One lakh sq m of built up processing area</li> <li>● at least 50% of area must be processing area</li> </ul>

The only requirements other than the above are that, in case the applicant is setting up a special purpose vehicle for the SEZ, it must have at least 26% of the equity in the vehicle<sup>168</sup>, and that the State government should inform the Board if “the proposed area falls under reserved or ecologically fragile area”<sup>169</sup>.

The Board of Approvals then may approve the proposal, approve it subject to conditions or

<sup>161</sup> The April 5<sup>th</sup> EGOM meeting is said to have changed this to 50%, and imposed a maximum size ceiling of 5000 hectares on multi product SEZ's.

<sup>162</sup> Rule 5(2)(a) of the Rules.

<sup>163</sup> Rule 5(2)(b) of the Rules.

<sup>164</sup> Rule 5(2)(b) as amended in March 2007.

<sup>165</sup> See footnote 5 above.

<sup>166</sup> Rule 5(2)(b) of the Rules.

<sup>167</sup> Rule 5(2)(c) of the Rules.

<sup>168</sup> Rule 5(4) of the Rules.

<sup>169</sup> Rule 5(6) of the Rules.

reject it<sup>170</sup>. If it approves, in cases where the developer is in possession of the land, the Central government then issues a 'formal approval'; in other cases, 'in principle' approval is granted<sup>171</sup>. This must be done within thirty days. Formal approvals are valid for three years (extendable to five) and in principle approvals for one (extendable to three)<sup>172</sup>. Within these time limits, in principle approvals must be converted to formal approvals. Developers who have received formal approvals must show that the land is contiguous and 'vacant', as well as a certification from the State government that they are in possession of the land, have "irrevocable rights" to it (or have leased it for a minimum of twenty years) and the land is free of all other encumbrances<sup>173</sup>. The Board has the power to relax any of these requirements, excepting the requirement for the land to be vacant<sup>174</sup>.

Once satisfied that the minimum area is covered, the Central government can notify the SEZ into existence<sup>175</sup>. A March 2007 amendment added a provision stating that if a developer acquires sufficient land after notification or approval, a single sector SEZ can be converted into a multi product SEZ at a later date<sup>176</sup>.

These land and processing area specifications are the only specific and concrete requirements for an SEZ to be declared. The Act does however also state that, at the time of final notification, the Central government is to be "guided" by the following<sup>177</sup>:

1. generation of additional economic activity;
2. promotion of exports of goods and services;
3. promotion of investment from domestic and foreign sources;
4. creation of employment opportunities;
5. development of infrastructure facilities; and
6. maintenance of sovereignty and integrity of India, the security of the State and friendly relations with foreign States.

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<sup>170</sup> Section 3(9) of the Act.

<sup>171</sup> Rule 6(1) of the Rules. It should be noted that these categories of 'formal approval' and 'in principle approval' were only created by the March 2007 amendment, but were already being followed by the Board of Approvals in 2006.

<sup>172</sup> Rule 6(2) of the Rules, as amended in March 2007.

<sup>173</sup> Rule 7(1) of the Rules, as amended in March 2007.

<sup>174</sup> Rule 7(2) of the Rules, as amended in March 2007.

<sup>175</sup> Section 5 of the Act.

<sup>176</sup> Rule 5(2)(d) of the Rules, added by March 2007 amendment.

<sup>177</sup> Section 5 of the Act.

The use of the term “guided” presumably implies the power to refuse to notify an SEZ on the grounds that it does not satisfy these requirements. But two factors should be noted: first, this consideration occurs not at the stage of approval – the logical stage for it to occur, for it is there that a specific authority (the Board of Approvals) is considering the proposal – but at the stage of final notification, when land acquisition is complete. Second, no authority is made responsible for ensuring this “guidance”. Third, the specified factors are extremely nebulous, and it would be difficult to find any industrial or service project that did not satisfy at least one. These three factors combined make this provision essentially meaningless.

Thus the only requirements that actually apply to the creation of an SEZ are the minimum land area requirements specified above. Creating a zone is as simple as finding land for it. *The SEZ Act and Rules do not in any sense specify a coherent policy for when, how and by whom SEZ's should be allowed; and objectives of exports, industrialisation, employment, etc., are effectively deemed irrelevant to the declaration of the SEZ.*

### ***Operations in SEZ's***

Once the Zone is created, the Central government appoints a Development Commissioner for the Zone<sup>178</sup>. This Commissioner has enormous powers, which are described below, but his or her primary mandate is to “ensure speedy development of the Special Economic Zone and promotion of exports therefrom.”<sup>179</sup>

Along with the Development Commissioner, the Centre also appoints an “Approval Committee” consisting of<sup>180</sup>:

1. The Development Commissioner – Chairperson;
2. Two Central government officers;
3. Two officers representing the Central department dealing with revenue;
4. One officer representing the Central department dealing with economic affairs;
5. Two officers from the State government;
6. A representative of the Developer.

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<sup>178</sup> Section 11 of the Act.

<sup>179</sup> Section 12(1) of the Act.

<sup>180</sup> Section 13(2) of the Act.

Note that the composition reduces to five Central government representatives, including the chair, two State government representatives and one Developer's representative. All officers are once again only from the Commerce and Finance Ministries. No effort is made to include other interests, and the mandate of all concerned is the promotion of exports and the SEZ.

Initially, the Development Commissioner demarcates areas within an SEZ as “processing” areas, for manufacturing goods or rendering services, and “non-processing areas” for any other activity<sup>181</sup>. Meanwhile, the Developer has to seek permission from the Board of Approvals for any operations in the SEZ<sup>182</sup>, which will then be eligible for duty drawback, tax incentives, etc.<sup>183</sup>

“Entrepreneurs” - to use the term used in the Act – who wish to set up units in the SEZ have to apply to the Development Commissioner with a copy to the Developer. These applications are forwarded to the Approval Committee, which then has to take the following factors into account when approving the application to set up a unit<sup>184</sup>:

1. The unit would have a positive net foreign exchange earning within the first five years<sup>185</sup>;
2. The Developer confirms that there is space in the processing area for the unit, though no actual lease agreement can be concluded until approval is granted;
3. The applicant undertakes to fulfill applicable environmental and pollution control norms;
4. The applicant is a resident and has a good financial record;
5. Various sector-specific requirements for certain industries;
6. Approvals of units that involve transfer of machinery from the Domestic Tariff Area should not be allowed, as per a clause added in October 2006.<sup>186</sup>

If the Approval Committee approves, the Development Commissioner issues a letter of approval and authorises the unit to undertake operations<sup>187</sup>. Units are then granted land in the processing area by the Developer on the basis of a lease agreement (the Developer cannot sell the

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<sup>181</sup> Section 6 of the Act and Rule 11(1) of the Rules.

<sup>182</sup> Section 4(2) of the Act.

<sup>183</sup> Rule 9 of the Rules.

<sup>184</sup> Rule 18(2) of the Rules.

<sup>185</sup> Rule 53 of the Rules.

<sup>186</sup> See Rule 18(3) of the Rules.

<sup>187</sup> Section 15(9) of the Act.

land)<sup>188</sup>. The Approval Committee and the Development Commissioner are then to monitor compliance of the units with the conditions specified in their letter of approval<sup>189</sup>. Special procedures are specified for applying for an “Offshore Banking Unit”, where the application is made to the Reserve Bank of India directly<sup>190</sup>, and for setting up units that require either FDI clearance or an industrial license, where the application is made to the Board of Approvals at the Centre<sup>191</sup>. In all cases the intention is that “single window clearance” should take place. Units or the Developer may also transfer their materials to sub-contract producers outside the zone, with units subject to returning the materials within 120 days but Developers able to sub-contract without any time limit<sup>192</sup>.

The sting, so to speak, is deep within this complex procedure. All the above requirements and process, including the net foreign exchange requirement, apply only to manufacturing or service units that wish to operate within the processing area of the SEZ concerned. The Developer, however, is free to use land in the non-processing area for “business and social purposes such as educational institutions, hospitals, hotels, recreation and entertainment facilities, residential and business complexes”, or to lease this land to any company authorised as a “co-developer” for similar purposes. All such developments will also be eligible for tax and other concessions if they are part of the ‘authorised operations’<sup>193</sup>.

On October 27, 2006, the Central government issued a guideline stating what operations can be authorised in SEZ’s<sup>194</sup>. The list for all types of SEZ’s includes restaurants, housing and apartments, club houses, gymnasiums, shopping arcades and retail space, multiplexes, schools, “convention or business centres” and – oddly enough – swimming pools. Hotels are allowed in all SEZ’s except IT, biotech and gems SEZ’s. This notification was issued at the height of the controversy on land acquisition and real estate speculation, and indicates that the Central government clearly wishes *all* SEZ’s (not just multi product SEZ’s) to see real estate as a part of their operations.

### ***Tax and Customs Concessions***

Units in SEZ’s and the Developer of an SEZ are entitled to complete duty exemptions on

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<sup>188</sup> Rule 11(6) of the Rules.

<sup>189</sup> Section 14(1)(f) of the Act.

<sup>190</sup> Section 17 of the Act.

<sup>191</sup> Sections 9(2)(c) and 9(2)(e) of the Act.

<sup>192</sup> Rule 41 of the Rules as amended in March 2007.

<sup>193</sup> Rule 11(10) of the Rules.

<sup>194</sup> Notification S.O. 1846(E) of the Ministry of Commerce and Industry, Department of Commerce, dated 27.10.06.

imports into an SEZ (which term includes goods from another SEZ or another unit in the SEZ<sup>195</sup>) and on exports from the SEZ to areas outside India. They are exempted from payment of Central excise or duties on goods imported from the Domestic Tariff Area (i.e the area outside the SEZ), payment of service tax, payment of central sales tax and payment of the securities transaction tax<sup>196</sup>. Most taxes and cesses are not applicable to goods procured from the Domestic Tariff Area<sup>197</sup>. Units enjoy a fifteen year income tax holiday, consisting of total exemption for the first five years, 50% for the next five years, and 50% on reinvested export profits for the following five years, while Developers get a 10 year 100% tax exemption<sup>198</sup>. These exemptions are also available to any contractor engaged for setting up a factory unit<sup>199</sup>. Service tax exemptions also apply, including to any service “related to an authorised operation” inside an SEZ. As mentioned above, duty free materials can also be used for the “business and social purposes” - i.e hotels, housing etc. - subject to approval by the Board of Approvals, so long as they are not for operation and maintenance purposes or for the personal needs of personnel<sup>200</sup>.

The Rules also demand that State governments exempt SEZ Units and Developers from all local taxes, duties and so on, including those levied by local bodies, for purchases from the Domestic Tariff Area<sup>201</sup>. Electricity taxes and duties are also required to be removed for electricity that is to be used within the processing area<sup>202</sup>.

This immensely attractive package is rounded off with a requirement that duty, customs, etc. must be paid on any 'exports' from the SEZ into the Domestic Tariff Area<sup>203</sup>. However, State government taxes will not apply on any sale in the Domestic Tariff Area<sup>204</sup>.

A few points should be noted on this incentive package. First, it bears a strong similarity to the existing Export Oriented Unit scheme, where units are already provided duty free imports of inputs and capital goods<sup>205</sup>. They were also given a tax holiday of 100% on export profits for the first five years and 50% for the next five years<sup>206</sup>. The only significant differences with the SEZ policy are that an

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<sup>195</sup> See definition given in section 2(o) of the Act for the term “import.”

<sup>196</sup> Section 26(1) of the Act and, for imports from the DTA, see Rule 27(1) of the Rules.

<sup>197</sup> Section 7 of the Act and the First Schedule to the Act.

<sup>198</sup> Section 27 of the Act and the Second Schedule to the Act.

<sup>199</sup> Rule 27(1) of the Rules, as amended in March 2007.

<sup>200</sup> Rule 27(3) of the Act.

<sup>201</sup> Rule 5(5)(a) of the Rules.

<sup>202</sup> Rule 5(5)(b) of the Rules.

<sup>203</sup> Section 30 of the Act.

<sup>204</sup> Rule 5(5)(a) of the Rules.

<sup>205</sup> See notification 22/2003-CE dated 31.03.2003 and 52/2003 dated 31.03.2003 of the Department of Customs and Central Excise.

<sup>206</sup> Chandrasekhar 2006.

additional condition was imposed in the EOU scheme – goods worth a maximum of 50% of the value of the unit's exports can be sold in the Domestic Tariff Area<sup>207</sup> – and that, of course, the units did not have to be inside a zone. Thus there is little that distinguishes the SEZ package from this incentive scheme, at least as far as units are concerned.

Second, other than the requirement for positive net foreign exchange earnings by units, the SEZ policy imposes no other discipline or regulation for tax concessions. Positive net foreign exchange earnings can, of course, occur even if no significant exports are taking place – even an insignificant exchange earning would be acceptable, so long as it is positive. There is no restriction on how much can be sold in the domestic tariff area, or on the amount of value addition within the SEZ. This means there is essentially no discipline in favour of export promotion or value addition<sup>208</sup>.

Third, there is ample possibility for revenue leakages in this scheme, where tax concessions for contractors are provided, and service tax concessions made available to any activity related to an authorised operation inside an SEZ. Monitoring and implementing such provisions will be very difficult, leading to widespread tax evasion<sup>209</sup>.

Fourth, the requirement of net foreign exchange makes tax concessions for SEZ's into an export subsidy – which is now barred by the Agreement on Subsidies and Countervailing Measures of the WTO (see chapter 1). Therefore, any exports from SEZ's can be subjected to countervailing duties by importing countries.

Fifth, the position of the developer is very striking. The net foreign exchange requirement clearly does not apply; there is no minimum infrastructure requirement<sup>210</sup>, except vague statements in the case of IT zones<sup>211</sup>; nor any minimum number of units. In short, there is no requirement that the SEZ must 'succeed' in any sense. In essence the developer thus only needs to ensure that they attract sufficient units to recover their own costs, and any profits above that level are guaranteed to be tax free. The only possible safeguard is the approval conditions imposed by the Board of Approvals, but the Board is not bound to do so, and considering the speed at which this Board has been issuing approvals (see next chapter), the likelihood of meaningful conditions being imposed is next to zero. Even if conditions are imposed, there is no penalty whatsoever against a developer except possible suspension

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<sup>207</sup> *Ibid.*

<sup>208</sup> Dr. U.K. Sen, personal communication.

<sup>209</sup> Dr. U.K. Sen, personal communication.

<sup>210</sup> Rao 2007.

<sup>211</sup> Rule 5A, inserted by an amendment in October 2006, requires that IT zones must be provided with 24 hour power supply, reliable connectivity, provision for air conditioning, and a “ready to use plug and play system for end users.”



of their letter of approval, but even in that case the developer's letter of approval can at most be transferred to another party – and the terms, conditions and consideration for the transfer are settled between the developer and the transferee<sup>212</sup>. In short, developing an SEZ is a no-loss proposition for any developer to engage in.

### ***Regulatory Arrangements and Relaxations***

In the effort to produce a single window clearance system, applications for almost all aspects of running a business (such as electricity and water connections, permissions for sub-contracting, SSI registration, pollution control clearance, etc.) are made to the Development Commissioner at the time of applying for an approval for a unit<sup>213</sup>. The Rules do not specify what is to be done by the Development Commissioner with these applications, but do require that States should provide a “single point” clearance system for State Acts and Rules<sup>214</sup>.

Some States' existing SEZ policies already delegate various regulatory bodies' powers to the Development Commissioner. In particular, pollution control boards' powers have often been delegated to the Development Commissioner or SEZ industries have simply been exempted from pollution clearance. The no-development zone on coasts will not apply to SEZ's in some States. However, Central environmental clearance remains applicable, with a relaxation that those SEZ's with a “homogenous type of industries” or a “pre-defined set of activities” need only take environmental clearance for the zone as a whole, not for individual units<sup>215</sup>.

Generation of electricity is to be allowed within an SEZ<sup>216</sup>. The State government is also required to provide “water, electricity and other services” that may be required by the developer, a sweeping provision that has no escape clause<sup>217</sup>. SEZ developers are thus now legally entitled to get whatever services they wish, regardless of whether the State government has the resources or should feel it appropriate.

A final point in this regulatory relaxation is a sweeping power given to the Central government to direct that “any of the provisions of this Act (other than sections 54 and 56) or any other Central Act

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<sup>212</sup> Section 10(9)(b) of the Act.

<sup>213</sup> Rule 17(1) of the Rules.

<sup>214</sup> Rule 5(5)(h) of the Rules.

<sup>215</sup> See Environmental Impact Assessment Notification No. S.O. 1533, dated 14.9.2006, of the Ministry of Environment and Forests.

<sup>216</sup> Rule 5(5)(c) of the Rules.

<sup>217</sup> Rule 5(5)(d) of the Rules.

or any rules or regulations made thereunder or any notification or order issued or direction given thereunder” will not apply to SEZ's<sup>218</sup>. In short, the Central government may modify or repeal *any* Central law as it applies to SEZ's (with the exception of labour law, as detailed below). This power is arguably unconstitutional, since it *de facto* amounts to allowing the Central government to assume legislative powers that should rightly belong to Parliament.

### ***Labour Laws***

After pressure from the Left parties, the SEZ Act was adjusted to state that the Central government's powers to repeal or modify laws would not apply to any law or regulation “relating to trade unions, industrial and labour disputes, welfare of labour including conditions of work, provident funds, employers liability, workmen's compensation, invalidity and old age pensions and maternity benefits applicable in any Special Economic Zones.”<sup>219</sup> This was intended to provide a protection against labour laws being suspended in SEZ's, which, as discussed in the previous chapter, has been a consistent demand of businesses and industries operating in EPZ's and SEZ's.

But this seemingly blanket protection is undermined by other legal provisions in the Rules and elsewhere. Thus, the Rules require that State governments declare SEZ's to be public utility services and delegate the powers of the Labour Commissioner<sup>220</sup> to the Development Commissioner<sup>220</sup>, even though in India's federal system it is actually the State government's prerogative to decide if such measures are necessary. Moreover, one should note that the Development Commissioner's overriding mandate is the “speedy development” of the SEZ and the promotion of exports, two requirements which are unlikely to be seen as harmonious with workers' interests.

Meanwhile, many State policies for SEZ's invoke exemption clauses in the various labour laws to ensure that the provisions of those Acts will in any case be relaxed (the SEZ Act only bars the Central government from relaxing labour laws). These include exemptions from the Minimum Wages Act, from the Contract Labour (Regulation and Abolition) Act, Employees State Insurance Scheme, requirements for posting information, and so on.

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<sup>218</sup> Section 49 of the Act.

<sup>219</sup> Section 49 of the Act.

<sup>220</sup> Rule 5(5) of the Rules.

## *Institutions and Government*

The SEZ Act and Rules together provide a comprehensive scheme for the governance of SEZ's, which, as argued in the previous chapter, is a key aspect of zones. First, the Development Commissioner in most States is the authority for most clearances and for labour rights. This in large measure transfers the regulatory authority of various state bodies to the Development Commissioner.

Second, judicial and policing functions are altered. “No investigation, search or seizure shall be carried out in a Special Economic Zone by any agency or officer” except with the permission of the Development Commissioner<sup>221</sup>. The only exception is in the case of “notified offences”, which the Central government can notify under section 21 of the Act. Even in the case of such offences, the Development Commissioner must be intimated<sup>222</sup>. The Act also provides that there will be special courts set up in SEZ's for both civil and criminal matters, and these courts will be the only courts that can hear any civil dispute within an SEZ or any trial of a “notified offence.”<sup>223</sup> Ordinary criminal trials of non-notified offences can take place in ordinary courts, but note that no investigation of such crimes is possible without the authorisation of the Development Commissioner. Appeals from the special courts will lie directly with the High Court of the State<sup>224</sup>. These provisions together thus produce a system of a separate judiciary for the SEZ where, once again, the Development Commissioner plays a key role.

Third, infrastructure and public services are also altered. Section 3(11) of the Act states that no infrastructure can be provided in an SEZ by any person or State Government except by agreement with the Developer. In its “Model State Policy” under the earlier SEZ policy, the Central government had also advocated that the electricity distribution company – which will probably be controlled by the Developer – may fix tariffs as they wish<sup>225</sup>.

Perhaps most revealingly, there are also efforts to change the structure of local governance, namely the gram panchayats and municipal elected bodies. Thus, the State policies on SEZ's of Andhra Pradesh, Gujarat, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu,

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<sup>221</sup> Section 22 of the Act.

<sup>222</sup> Section 22 of the Act.

<sup>223</sup> Section 23 of the Act.

<sup>224</sup> Section 24 of the Act.

<sup>225</sup> Section 5 of the “Model State Policy on SEZ's”, available at [http://sezindia.nic.in/state\\_policy\\_new.asp](http://sezindia.nic.in/state_policy_new.asp). Last accessed on March 1, 2007.

Uttar Pradesh and West Bengal<sup>226</sup>, as well as the Central government's model policy, all declare that SEZ's will be notified as “industrial townships” under Article 243Q of the Constitution. This exempts them from the provisions of Part IX of the Constitution, which provides for elected local governments. In their place, an industrial township authority is constituted with the same powers and duties as a municipal body. In Maharashtra, in the case of SEZ's, the draft Maharashtra Special Economic Zones Act stated that this body would have three nominees of the Developer and two of the State government<sup>227</sup>. In West Bengal, as per section 28(2) of the West Bengal Special Economic Zones Act, the governing body consists of three government representatives, one representative of the developer and two representatives of the units in the zone<sup>228</sup>.

Thus, the intention is clear – no democratic local governance institutions are meant to exist in Special Economic Zones. Powers will be granted to officers of the concerned government departments and to the SEZ developer. Thus, in a situation like the Maharashtra Act, the developer will be both the private party responsible for constructing the zone and also effectively in control of the local government. They will then be in a position to control infrastructure provision and provision of basic services, such as schools, primary health centres, roads and so on. In short, both the executive and the local democratic institutions will be effectively replaced by the Development Commissioner and the Developer.

This overall scheme of governance – or, more accurately, extreme centralisation of power – has received relatively little attention in the debate around SEZ's. It is complimented at the legal level by the power of the Central government to repeal or modify any law that it wishes. Read together, this amounts to building a structure of governance where every arm of the state, be it police, judiciary, public services, local government, or regulation, are all brought under the control of the Development Commissioner, the Developer or the Central government. The scheme of separation of powers and division of responsibility, not to mention democratic accountability, are entirely ignored.

The final nail in this project is hidden deep within the Act and the Rules. Throughout the discussions of the previous chapters, one theme that emerged repeatedly is that the sheer physical isolation of zones – with fences, heavy security and so on – is itself one key factor in the destructive consequences of zones. The isolation of residents and workers in zones from the outside world is a key

<sup>226</sup> See [http://sezindia.nic.in/state\\_policy\\_ent.asp](http://sezindia.nic.in/state_policy_ent.asp). Last accessed on March 1, 2007. Please note that this list of States includes all the States whose policies are posted on the web site, and it is hence a reasonable assumption that this is the case across the country.

<sup>227</sup> *Ibid.*

<sup>228</sup> *Ibid.*

facilitator of repression and illegality.

It is hence particularly striking that, in an unusual step in a legislation, the SEZ Act itself insists that “Every person, whether employed or residing or required to be present in a Special Economic Zone, shall be provided an identity card”<sup>229</sup>. Meanwhile, the Rules originally went even further and, in an astonishing exercise of detail, stated that “The processing area and Free Trade and Warehousing Zone shall be fully secured by boundary wall or wire mesh fencing having a height of at least two meters and forty centimeters above plinth level with top sixty centimeters being barbed wire fencing with mild steel angle with specified entry and exit points.”<sup>230</sup> This clause has now been modified, but the intent remains<sup>231</sup>. The Rules also provide that only “authorized persons” may enter the processing area<sup>232</sup>.

These are matters that would normally be dealt with by the concerned local administrator, or the State government at most. It is hence a sign of how important the authorities see such matters that they were included in the Central legislations – and indeed, in the case of ID cards, given statutory force! Clearly there is an overwhelming concern to ensure that SEZ's throughout the country are walled off, and particularly that there be very tight control on entry and exit into the zones.

Again, one has to look at these provisions not as administrative details but as political indicators. Looked at it in this light, the vision emerges very clearly – SEZ's are to be islands under extremely centralised rule by the Developer and the Development Commissioner, physically, legally and politically sealed off from the rest of the country. Decades of struggle for local democracy, transparency and accountability have all been brushed aside. Accusations that SEZ's will function like colonies are frequently dismissed as inflammatory rhetoric; but it is difficult to see how the reality is very far from this.

## ***Conclusion***

The new SEZ Act and Rules do share commonalities with the earlier EPZ strategies of India, but they essentially represent a major departure. This departure is one of degree – in terms of the incentives offered – but also one of kind. Qualitatively, in two major areas the SEZ Act has shifted

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<sup>229</sup> Section 46 of the Act.

<sup>230</sup> Rule 11(2) of the Act.

<sup>231</sup> In March 2007, this clause was replaced with a requirement that the processing area and an FTWZ shall be “fully secured with measures approved by the Board of Approval.”

<sup>232</sup> Rule 11(4) of the Act.

India's policy. First, it has placed EPZ's and SEZ's at the centre of a new investment and export strategy for the first time in India's history. Second, and more critically, it has shifted the politics and discourse of EPZ's / SEZ's.

It is worth considering the latter point in more depth. In the earlier policy, particularly that prior to 2000, EPZ's were part of a government-driven strategy aimed at directing investment and exports in accordance with other policy decisions. This is the 'classical' EPZ model that exists throughout the world, where EPZ's form part of a more or less conscious top-down strategy.

But the new SEZ Act and policy are radically different in their approach. SEZ's are seen not as a geographical component of an economic strategy, but as an incentive system to be offered on application. The policy is to be driven not from the top by strategy but from the bottom by demand. Moreover, as we saw above, the SEZ Act does not specify any broader policy framework or economic plan within which SEZ's are to be approved and administered; instead, it provides a structure of incentives and governance, while leaving the actual strategic purpose of SEZ's essentially to the discretion of the government. Moreover, the incentives and structures provided are so powerful and sweeping that they create enclaves, not only in the economic sense, but in the political and legal sense as well.

This kind of legislation appears to be unique in the world, and reads like a highly exaggerated version of standard EPZ policies. But it is not only this. It is also a reversal of the normal practice of legislative affairs, and indeed – one can safely say without exaggeration – of the structure of parliamentary democracy. In our Constitutional system, it is Parliament that is to set the mandate and policy of the executive, while the executive has the power to make decisions on policies that fall within that mandate and to decide on the administrative measures necessary to implement them. But the SEZ Act provides neither mandate nor policy. It provides an administrative toolkit, while handing over the power of defining when, where and how that toolkit should be used to the executive.

It is this political and economic reversal that is the defining feature of the SEZ Act. It reflects a power balance that favours executive over legislature, business over the state and big capital over other sectors of society. More so than almost any other EPZ policy anywhere in the world, Indian SEZ's constitute an institutional shift in power so severe that they are almost an abdication in favour of investment capital. And, as we shall see in the next chapters, this single fact has become the *leitmotif* of the implementation of the SEZ policy and the political struggle that has developed around it.



## CHAPTER VI: LIKELY ECONOMIC IMPACTS OF SEZ'S

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While there has never been a clear policy statement of the goals of the SEZ policy, three areas are commonly cited: investment (particularly in infrastructure), exports and employment. What are the probable the economic impacts of SEZ's in these areas? This chapter seeks to look both at current events and also to consider likely future consequences, while keeping in mind that the policy and political environment are both rapidly changing.

### *Investment in SEZ's*

In terms of investment, the ability to attract foreign and private sector investment were considered the two key selling points of SEZ's. Unfortunately there is no data as yet on the amount of FDI attracted by development of SEZ's, and since few new SEZ's have as yet come into operation, there is also no figure on the amount of FDI attracted by operations within SEZ's. The only data available appears to be a Ministry of Commerce estimate that 700 million dollars – approximately 3000 crores – of foreign investment is expected in SEZ's by the end of the fiscal year 2006 – 2007<sup>233</sup>. This is, as we shall see, a miniscule proportion of the predicted investment in SEZ's.

This fact becomes of particular interest in light of calculations performed by Rao (2007), which aim to estimate the amount of total investment needed for the SEZ's. She bases her calculations on statements by the Commerce Minister that Rs. 1,00,000 crore investment is expected to occur in infrastructure through the SEZ's over the next three years<sup>234</sup>. She takes this figure as a base estimate and attempts to estimate required total investment on the basis of three scenarios: 75% single sector SEZ's out of total SEZ's, an equal ratio between single sector and multi-product, and thirdly 25% single sector SEZ's. She finds that even in the first scenario – a majority of single-sector SEZ's, which require relatively less infrastructure and township investment – the total amount of investment required is 2.79 lakh crores. Even if split over two years (i.e from next year onwards), this amount is equal to 10% of Gross Fixed Capital Formation in the country and 27% of expected total private sector investment per year. In the other two scenarios, the amount of investment is even higher, reaching 61% of Gross

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<sup>233</sup> Financial Express 2006.

<sup>234</sup> Current estimates in the press state that Rs. 3,00,000 crores total investment in SEZ's is expected based on approved SEZ's, a figure that tallies with Rao's estimates for overall investment.



Fixed Capital Formation in the third scenario.

This is clearly far too high to be reasonably expected as new investment – it would require the private sector to invest more than the *total* annual growth of private sector investment in SEZ's alone. Two possible conclusions can be drawn from this fact.

First, foreign direct investment will flow in to supply additional investment. But it should be noted in this context that, over the past three years, India has received approximately Rs 1.06 lakh crores in FDI<sup>235</sup>. Assuming that the domestic private sector provides Rs.50,000 crore (approximately 2% of gross fixed capital formation) over two years, the above estimates would require FDI to the tune of Rs. 2.29 lakh crores into greenfield projects in SEZ's alone – more than twice the flow of the last three years and several orders of magnitude greater than the projection for this fiscal year given above. In this context one should note that FDI into India in the post liberalisation period has shown a preference for acquisitions of existing companies or at most investment into infrastructure, rather than greenfield export-oriented projects<sup>236</sup>. This is also reflected in the low rate of foreign investment in the pre-2005 SEZ's, which was discussed in the last chapter. To expect such an enormous flow of FDI is thus very unlikely. This is also a key difference with the Chinese SEZ's, where, as we saw, FDI from Hong Kong, Macau and Taiwan played a major role. India has no such source of capital.

This leaves us with the second possible conclusion, and in the circumstances by far the most likely: the new investment into SEZ's will not in fact be 1,00,000 crores. Such investment may simply never materialise, or existing investment will shift into SEZ's. The latter has been one of the consistent critiques of the SEZ Act and policy in its existing form, and it appears from these calculations that such shifting is very likely. Safeguards have been attempted against this now, including provisions against approvals of units, but these will be very difficult to enforce and are unlikely to be effective<sup>237</sup>. As we will see in the next section, there are other reasons for seeing this as probable as well.

### ***Tendencies in Sectoral Composition of SEZ Investment***

As noted in previous chapters, mere attraction of foreign investment or private investment

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<sup>235</sup> Estimate based on reported figures for 2004 and 2005 in UNCTAD Press Release, “Foreign Direct Investment Rose by 34% in 2006”, January 9, 2007, and reported figure for 2006 from Union Budget 2007-2008, converted at current exchange rates.

<sup>236</sup> Chandrasekhar and Ghosh 2000.

<sup>237</sup> The Union Budget for 2006-2007 provides that existing units cannot get SEZ exemptions by shifting to SEZ's (Chatterjee 2007). The effectiveness of such measures is highly questionable, however, given that they would be quite easy to evade (Rao 2007).

cannot be a policy goal in itself. What matters is the nature of such investment and the impacts it will have. For this a key set of data is indeed available, which is the set of approvals granted so far by the Board of Approvals. From its creation in early 2006 till the freeze on approvals was imposed in early 2007, the Board went ahead with SEZ approvals as if it were – to quote a supporter – “a body with a mission”<sup>238</sup>. The result was that by the time of the freeze the Board had granted formal approval to 237 SEZ applicants and “in-principle” approval to at least 162 others (though possibly more).

We can get some idea of the level and nature of investment that is being attracted by SEZ's by examining the list of SEZ proposals approved (both in principle and formally) so far. It can be objected that there is no reason to believe this pattern will continue, since it is clear that there are moves to, for instance, cap IT related SEZ's and 'go slow' on large multi product SEZ's that involve acquisition of land<sup>239</sup>. But what the existing pattern does do is give us some indication of the interests and approach of those investing in SEZ's, and thus the manner in which the policy is likely to be used by investors.

This analysis is based on list of formal and in principle approvals up to October 20<sup>th</sup>, 2006, available on the official SEZ web site<sup>240</sup>.

### *Sectoral Breakup of SEZ Approvals*

A breakdown of approvals granted so far (both formal and in principle) on the basis of sector and type of SEZ produces the following:

<i>Sectorwise</i>	<i>Approvals</i>	<i>Percentage</i>
Information Technology and ITES	181	44.91
Multi Product	69	17.12
Pharmaceuticals / Biotechnology	33	8.19
Footwear / Apparel / Textiles	31	7.69
Engineering / Metals / Mining	24	5.96
Services	12	2.98

<sup>238</sup> Shijith 2007.

<sup>239</sup> The former proposal has reportedly not been accepted by the Empowered Group of Ministers, while the latter has been accepted and multi product SEZ's capped at 5000 hectares.

<sup>240</sup> Interestingly, after that date the list was not updated and, later, taken off the web site entirely, presumably because of the opposition to SEZ's. However, a copy of that list is still available and is useful for analysis, particularly because very few approvals appear to have been granted after that time. The October 20th list shows 237 formal approvals (the same as the earlier figure) but 166 in principle approvals – three more than the figure cited earlier, which comes from a press report. In other words, some approvals were either cancelled – which seems unlikely – or the press report is quoting a mistaken figure. In any case, it is clear that few approvals were granted after October 20th.

Hardware / Electronics	8	1.99
Automobiles	7	1.74
FTWZ	6	1.49
Gems	6	1.49
Power	6	1.49
Other	20	4.96

The first and most striking feature of the approvals granted so far is the dominance of single sector IT SEZ's, which constitute 45% of all approvals (and 62% of formal approvals). The next largest category, multi-product SEZ's, is a distant second. SEZ's are in large measure becoming an IT zone scheme, to the extent that the government decided in November 2006 to stop further in principle approvals of IT SEZ's (while allowing formal approvals where land had been acquired)<sup>241</sup>.

Why should there be such a demand for IT SEZ's, particularly when the IT sector already enjoys a wide range of exemptions and incentives? The reason is not difficult to see. The main scheme for IT incentives, the Software Technology Parks Initiative, is due to end in 2009. IT industry leaders have already been attempting to get this scheme extended, but with no result as yet. In this context, shifting into SEZ's allows for an extension of tax and other exemptions for a further period of a decade.

This kind of IT exemption-hunting has three implications. First, it strengthens the case made above that the SEZ exemption system may be promoting shifting of existing investment rather than creation of new investment.

Second, even where investments are in fact “new” in the sense of new units, the SEZ's are failing one key test of an EPZ policy – encouraging diversification and dynamic change in the industrial pattern and export composition of a country. The justification for SEZ incentives and infrastructure is that barriers in the existing economy are hampering industrial innovation and development. However, the focus on IT sector SEZ's indicates instead that applicants for SEZ's are using the policy not as a tool towards new sectors, but as a method of expanding existing profits and existing ventures on the basis of incentives. Since the SEZ Rules moreover provide no disincentive to such behaviour (such as requirements for increasing value addition or directed credit), there is not much reason to believe that it will change in future.

Finally, the dominance of IT SEZ's is so overwhelming that it might be argued that a cap on such SEZ's may well diminish private sector interest in the policy. If this does occur, it would be a

<sup>241</sup> PTI 2006; the Empowered Group of Ministers has now reportedly decided to end this freeze.

telling statement on the failures of the Act. But assuming that this does not occur, let us look at the next largest sector-specific SEZ categories: pharmaceuticals and textiles. Both areas share with the IT sector the fact that India's primary competitive advantage is low costs, and moreover apparel and textiles were India's third largest export in 2006-2007<sup>242</sup>. In the case of textiles, cost reduction again seems to be the primary motivation for movement into SEZ's, since textiles are, as described in chapter 2, a low value added and highly 'footloose' industry. In the case of pharmaceuticals, it can be argued that movement into SEZ's will result in a growth in this export sector (currently approximately 2.5% of India's exports<sup>243</sup>) and technological transformation due to economies of scale. That may be the case, but the pharmaceutical industry is capital intensive and has relatively low linkages with the rest of the economy. It may thus follow the same route as the IT industry, building on low costs and failing to significantly move up the value addition chain<sup>244</sup>. At the least, there is little in the SEZ Act or Rules to prevent it from doing so.

In sum, there is little to show SEZ's contributing to either a change in India's industrial and export-oriented investment patterns or an expansion into new sectors, as well as evidence that the primary motivation of investors may be exemption hunting by existing industries. The final remaining category of interest is the multi product SEZ's, which are hailed by many commentators as the truly new and revolutionary idea within SEZ development. This type of SEZ is examined in more detail in a separate section below.

### *Investment in the Development of SEZ Infrastructure*

Other than new sectors of economic growth, the SEZ's were also touted as producing a major rise in the investment level in infrastructure. The approvals list would initially tend to support this claim. Sixty six approvals – or 19% of the total – were given to public sector applicants, of which the vast majority were State government industrial development corporations. The remainder all went to the private sector parties or to joint ventures between the private and public sectors. Thus the majority of SEZ development investment is almost certainly private sector investment.

When we look within private sector investment, the picture is more complex. A rough breakdown was attempted of the nature of non-public sector companies that have received approvals. Approximately 33 approvals were given to companies whose sector could not be identified, and

<sup>242</sup> From data available from the Director General of Foreign Trade, <http://dgft.delhi.nic.in>.

<sup>243</sup> *Ibid.*

<sup>244</sup> Chandrasekhar 2005.

another 28 appeared to be given to special purpose vehicles or joint ventures. Leaving these 61 approvals aside (approximately 18% of non-public sector applicants), the breakup of the remaining private sector applicants was roughly as follows:

<i>Sector</i>	<i>Number of Approvals</i>	<i>Percentage</i>
Real Estate and Other		
Developers <sup>245</sup>	167	60.95
Information Technology	34	12.41
Drug	17	6.20
Investment / Holdings / Finance	14	5.11
Industrial	9	3.28
Engineering	7	2.55
Logistics / Export	6	2.19
Textile / Footwear / Apparel	5	1.82
Mining / Metals	4	1.46
Gems	3	1.09
Other	8	2.92

Or, in a graphical form:

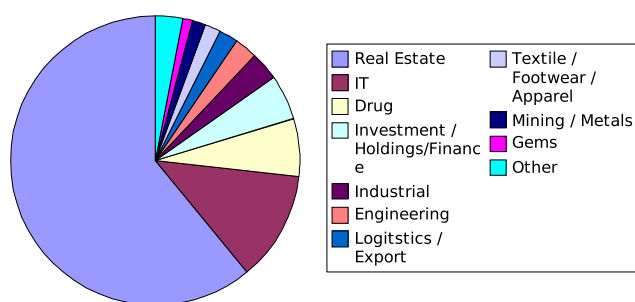


Figure 1: Breakup of Approvals By Type of Developer

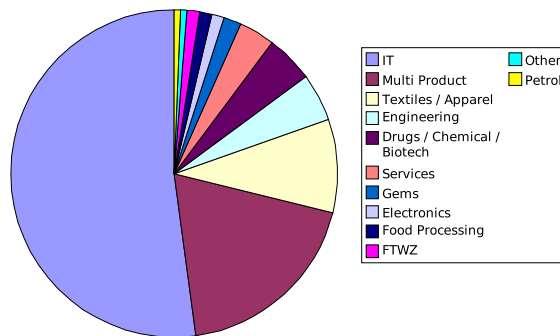
<sup>245</sup> Companies were identified as real estate enterprises if they could be recognised as such – such as DLF, Parsunath, Omaxe, and so on – or if their name contained and was limited to words such as “builders”, “constructions”, “infrastructure”, “developer” etc.

The most obvious feature of this chart is the dominance of the real estate sector. Real estate sector applicants form 61% of the approvals granted so far. IT companies form the next largest chunk, with 12% of approvals, so that together real estate companies and IT companies have received nearly three quarters of non-public sector approvals.

We are already familiar with the reason for such a high level of interest among IT sector companies. With very few exceptions, both the IT companies and the other non-real estate companies applied for sector-specific SEZ's for their own sector – in short, attempting to capture exemptions for their respective production units. But what is of real interest is the real estate sector, whose dominance in SEZ applications is arguably the intended result of the policy. Who better to engage in large scale infrastructural investment than big real estate and infrastructure firms?

But, once again, let us disaggregate further and note the sectors of SEZ's into which real estate companies have been investing. The breakdown is as follows:

<i>Sectorwise</i>	<i>Approvals</i>	<i>Percentage</i>
IT	87	52.10
Multi Product	32	19.16
Textiles / Apparel	15	8.98
Engineering	8	4.79
Drugs / Chemical /		
Biotech	8	4.79
Services	6	3.59
Gems	3	1.80
Electronics	2	1.20
Food Processing	2	1.20
FTWZ	2	1.20
Other	1	0.60
Petrol	1	0.60



*Figure 2: Breakup of SEZ Approvals Granted to Real Estate Companies*

The sectoral distribution is thus even more skewed than the overall sectoral distribution of SEZ's. Two types of SEZ's, IT and multi product SEZ's, form 70% of all applications by real estate companies. More than half of the SEZ's applied for by real estate companies are IT SEZ's. Moreover, an additional 15% of approvals are for sectors in which India is already strong in exports – textiles, services and gems. Thus fully 85% of all approvals are for either multi-product zones or for traditional export sectors.

Thus, the arguments made above about uses of the SEZ policy are even more true of private real estate sector investment than they are of the general policy. The country's real estate investors are not competing to build new infrastructure for new industries, but in particular to gain access to provision of infrastructure for IT companies – an area where additional investment, while welcome, was not in need of a new incentive policy. Thus once again rather than building a space for new opportunities, SEZ's appear to be becoming a space for intensification of old ones.

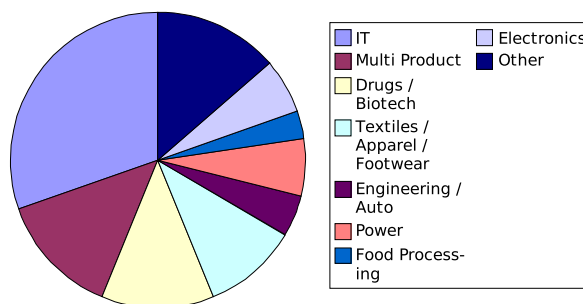
It is not difficult to understand the reasons for this behaviour. Developers' primary goal in the creation of SEZ's is to draw sufficient units to make as large a tax-free profit as possible<sup>246</sup>. As mentioned in the previous chapter, nothing else is required of them. Therefore, the approach of developers will be to focus on sectors that are more likely to draw units rather than on those where units are more scarce – or where units can in any case benefit from the Export Oriented Unit scheme. Hence the focus on IT and traditional export sectors.

An illustration of this can be drawn by comparing the picture of real estate investment with that of public sector investment. The desire for short-term tax free profits is unlikely to be as much of a

<sup>246</sup> Chandrasekhar 2006.

factor in public sector investment, while other factors such as politically perceived needs for employment, 'success' of certain sectors and so on may intervene. Thus, the difference in patterns between public and real estate sector investments can be seen as a very rough indicator of the effects of the incentive scheme on the private sector, other factors being presumed to be equal. The breakup of public sector SEZ approvals is as follows:

<i>Sectorwise</i>	<i>Approvals</i>	<i>Percentage</i>
IT	20	30.3
Multi Product	9	13.64
Drugs / Biotech	8	12.12
Textiles / Apparel / Footwear	7	10.61
Electronics	4	6.06
Power	4	6.06
Engineering / Auto	3	4.55
Food Processing	2	3.03
Other	9	13.64



*Figure 3: Sectorwise Breakup of Public Sector SEZ Approvals*

Thus, for the public sector, while IT sector SEZ's remain the largest sector, their dominance is less and the sector-wise approvals far more balanced. Going on the basis of the assumptions made above, this indicates that the tax concession scheme of SEZ's for developers is in fact drawing investment away from other sectors of SEZ's and into sectors with large levels of existing units, proven markets and



exemption-seeking industries – precisely the opposite of the stated goal of the policy.

If diversification of investment, industry and sectoral export composition is a goal of the SEZ policy, public sector investments are doing far better than their real estate counterparts.

### ***Exports from SEZ's***

The next claim for SEZ's often made is about exports, both in terms of a quantitative increase in exports and a qualitative dynamic transformation towards higher degrees of value addition and higher technology levels. First, can SEZ's lead to a quantitative expansion in exports?

In the context of her calculations noted above, Rao (2007) notes that in her three scenarios (all based on the unlikely assumption of 1,00,000 crores of new infrastructure investment in SEZ's), output estimations show new SEZ exports composing between 7% to 9% of India's total exports. If invisibles are included in export income, this drops to half. This share is comparable to the share of Export Oriented Units, as mentioned in the previous chapter, and is less than one third the annual rate of growth of exports, which has averaged 18% over the last five years<sup>247</sup>. The estimate is based on Rao's assumption that the incremental capital-output ratio of the SEZ's will be similar to the overall economy<sup>248</sup>. In short, in order to achieve any significant growth in exports, or even a significant share of existing exports, SEZ's would have to attain a level of productivity far, far higher than that of the rest of the economy – even if 1,00,000 crores of new investment materialises.

Is this higher productivity very likely? It is indeed one of the central arguments of SEZ proponents that the concessions, reduction in “over-regulation”, withdrawal of state 'interference' and provisions for the private sector to provide infrastructure would lead to higher efficiency and greater productivity. One test of such a hypothesis would be the effects of incentives on the existing EPZ's, converted to SEZ's under the new policy of 2000. While industries claimed that that policy left much to be desired, there is no doubt that there was a general relaxation of regulation and an extension of incentives to the EPZ's under that policy. Indeed, the customs and excise exemptions of the SEZ Act had already been provided to SEZ units from 2000 and to SEZ developers from 2002<sup>249</sup>.

But, as we saw in the chapter 4, growth in exports, productivity per worker and other indices all

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<sup>247</sup> Rao 2007.

<sup>248</sup> Further, as Rao points out in her analysis, the ICOR for manufacturing or services sectors are considerably higher than that for the economy as a whole – and hence she has in fact used the most liberal estimate possible.

<sup>249</sup> See customs notifications 39/2002 Central Excise and 82/2002 Customs, both dated 13.8.2002, for developers, and 52/2000-CE and 137/2000-Cus, both dated 19.10.2000, for units.

slowed during the post 2000 period<sup>250</sup>. In short, the incentives policy did not produce any major rise in productivity in and of itself. The other factor is the ability of the private sector to provide infrastructure, but, as we saw above, private sector infrastructure providers are not showing much interest in investment in areas other than traditional export sectors and multi product SEZ's. Traditional sectors, particularly IT SEZ's, are unlikely to show much higher productivity than they do with existing infrastructure in software technology parks and similar areas. The lack of any significant export requirement makes it all the more likely that SEZ units and developers will be largely indifferent to export potentials.

Thus the overall claim of a major contribution to India's exports from SEZ's appears very unlikely to occur. This leaves the question of whether or not SEZ's can promote dynamic change in the export composition of the country and a shift towards greater value addition. First, as noted above, there is an inbuilt tendency in the policy to encourage construction of sector-specific SEZ's pertaining to existing export sectors rather than new ones. Second, the policy provides no requirements for increasing value addition, and instead promotes a blanket low cost model. As we noted in chapters 2 and 3, there is no reason to assume that the mere provision of incentives automatically will lead to an upgradation of value addition over time, except in the case where entirely new sectors are being created. This is precisely what appears to not be occurring. In short, if dynamic change does occur, it will not be the result of the SEZ policy but more of a fortunate byproduct.

The final nail in the coffin of any export expectations is, of course, the WTO agreements that now bar any use of export subsidies. The SEZ concessions are in the nature of export subsidies and exports from such zones, if they attain any degree of success, can look forward to being subjected to countervailing duties (Indian exports already experience more countervailing duties than those imposed on exports from other countries<sup>251</sup>). This would ensure that these export markets are effectively closed.

### ***Multi Product SEZ's***

It may be objected that multi-product SEZ's would be an exception to this rather grim overall picture, since they are a qualitatively different phenomenon than single sector SEZ's. In the public mind, they are also what is commonly understood by the term SEZ. Supporters of SEZ's in particular

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<sup>250</sup> Aggarwal 2005.

<sup>251</sup> Rao 2007.

strongly promote multi product SEZ's, on the grounds that their size and possible sectoral diversity will make them very similar to the Chinese “successes.” Moreover, it is often claimed that the multi-product SEZ's will become areas of excellent infrastructure, economies of scale and general dynamism.

The reality is significantly more complex. The first and most disturbing question about multi product SEZ's is the low requirement for processing area and the enormous amount of land that is thus left at the discretion of the developer. The questions of the acquisition of such land and the resulting displacement are dealt with in the next chapter. What is clear, however, is that the opportunities for speculation are enormous.

The Chinese experience is particularly apposite. In China, two factors led to rapid increases in land speculation: first, the dual track land classification system, leading to a segmentation between rural and urban land markets and large possibilities for speculators; and second, the ease with which investors, as a result of “zone fever”, could find political support for acquiring such lands and changing their classification to urban or industrial land use. The result was widespread speculation. One statistic quoted in chapter 3 bears repeating: rights over 127,000 hectares of land were granted to real estate developers between 1992 and 1993, but less than half of this land was actually developed<sup>252</sup>.

Both these factors exist in the current Indian land market. The use of the eminent domain powers of the state, embodied in the Land Acquisition Act, to acquire land for SEZ's has already become the most controversial aspect of the policy<sup>253</sup>. This leads to depressed prices for agricultural land and consequent speculative possibilities for the private sector developer, similar to those found in China.

The remedy most often proposed for this problem is a requirement that private parties should negotiate directly with those from whom land is being acquired, rather than the powers of the state being used. A further discussion on this is undertaken in the next chapter, but it is clear that it would not address the problem of speculation, for the land market in India is also segmented like that of China. The increase in value does not occur on acquisition by the state alone; it also occurs at the time of change of land use, when the classification of the land is changed from agriculture. This change is far easier for an industrialist or a real estate project to obtain than for a farmer, as seen by the experience of farmers in Jhajjar, Haryana<sup>254</sup>; but once the change in land use occurs, the value of the

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<sup>252</sup> Huang and Yang 1996.

<sup>253</sup> It should be noted in this context that the Empowered Group of Ministers has reportedly barred State governments from further land acquisition for SEZ's.

<sup>254</sup> Jha and Guha 2007/

land jumps automatically. Once again, there are ample possibilities for speculation.

This fact should be seen in light of the reality that there are no minimum conditions or requirements imposed on SEZ developers. It is thus entirely possible for a company to make high profits purely by taking possession of large areas of land (particularly if they do so by acquisition by the state), secure a change in land use and then engage in construction and lease of housing for far higher prices, after providing for the minimum processing area. These profits, meanwhile, would be tax free; and indeed a company could theoretically make money even if it left the processing area entirely empty. This kind of speculation is exactly what occurred in China, earning the practice the title “stir frying.”

Moreover, the second condition – the willingness of provincial or local governments to encourage this change of land use as a result of “zone fever” - is already present in India with the rush for SEZ's. The Central government has further issued guidelines making real estate operations eligible for being authorised in SEZ's. To expect that under such conditions real estate speculation will not occur, or indeed is not a motivation for the rush of real estate firms into multi product SEZ's, would be a remarkable assumption. Indeed, given the continuance of the EOU scheme, it will be difficult for many developers – especially in the context of so many SEZ's coming up – to draw large numbers of genuinely export oriented units to the SEZ when the EOU scheme offers a package almost as attractive<sup>255</sup>. In this context, speculation could be the major reason that SEZ developers would expect profits.

Such speculation will greatly harm the prospects of multi product SEZ's for genuine economic gains. Speculation will have a tendency to drive up land prices within SEZ's and thus, ironically, defeat the main attraction of SEZ's – low costs. For instance, speculation was a factor in increasing costs in Shenzhen and making the zone less attractive for foreign investors<sup>256</sup>. Second, with speculation being the primary motivation, the infrastructure constructed would be unlikely to be either high in quality or tuned towards productive sectors; the Hainan SEZ in China being once again an excellent example. The contribution of speculation to higher land prices in general and to other forms of macroeconomic instability and distortion cannot also be overlooked.

In short, there is no reason to expect enormous economic gains from multi product SEZ's purely on the grounds that they are large. Supporters of SEZ's sometimes appear to apply neoclassical

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<sup>255</sup> Chandrasekhar 2006.

<sup>256</sup> *The Economist* 1995.

economic logic at its extreme: simply 'withdraw' the state and the private sector will create a booming export sector, or even “attractive and functional new towns” with neither “democracy nor bureaucracy”<sup>257</sup>. Unfortunately, these claims are illogical and historically untenable, and the example cited most often for this argument – China – should in fact be a salutary warning.

## ***Employment***

The public policy defence cited most often for Special Economic Zones is the generation of additional employment. Indeed, during the Lok Sabha debate on the Special Economic Zones Act, the Commerce Minister went as far as to state that “One of the prime objectives of the UPA Government -- I think, it is one of the biggest challenges today -- is the challenge of creating not only additional employment but additional avenues of employment. ... [The main question in our minds was] how will [the SEZ Bill] not only drive investment but drive employment-driven investment? ... The Foreign Trade Policy which was announced by the UPA Government – which I announced – had one sole intention. We kept the focus on how we would generate employment.”<sup>258</sup>

Estimates of the number of jobs that SEZ's would generate vary very widely, ranging from five lakhs<sup>259</sup>, to 15 lakhs in the next four years<sup>260</sup>, to claims of 25 lakh jobs from the Maha Mumbai multi product SEZ alone<sup>261</sup>. It is not clear what the statistical basis for these various estimates is. We might note that the latter figure – 25 lakh jobs – is more than the total number of organised sector jobs created in the entire fifteen years since reforms began<sup>262</sup>, and is therefore most likely in the realm of fantasy.

Yet, these claims notwithstanding, the SEZ Act is transparently not an employment generation scheme. The assumption of the policy is that the additional investment and exports generated will result in higher employment, but the argument for this rarely goes beyond the truism that any additional economic activity results in new 'jobs'. There is no evidence in either the legal provisions of the SEZ Act or in the policy statements of the Central government that SEZ administration will be geared towards employment generation. In short, whatever employment effects that exist will be those that result automatically from higher investment.

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<sup>257</sup> See for instance Chakraverti 2006.

<sup>258</sup> Lok Sabha debates, 10.05.2005.

<sup>259</sup> Vaidyanathan 2006.

<sup>260</sup> Gupta 2006.

<sup>261</sup> Bunsha 2006.

<sup>262</sup> Citizens' Research Centre 2007.

Can we estimate the likely pattern of such effects? Some historical indicators exist. First, as discussed in chapter 4, the experience of Indian EPZ's and SEZ's since 2000 has been a sharp rise in capital intensity – between 1998 and 2003, a 73% growth in investment produced only a 13.7% rise in employment<sup>263</sup>. The very liberal norms on import of capital goods that now apply to SEZ's (and have done so since 2000) have presumably shifted manufacturing towards higher capital intensity. Moreover, the amount of SEZ employment would be dependent on the amount of new investment that is actually generated by the SEZ's. As noted above, this is questionable.

Whatever employment generation does occur would be a one time spurt in employment. Supporters of EPZ's often engage in what is essentially statistical jugglery by comparing the quantum of growth in employment, based on estimates like those above, with the abysmal annual rate of organised sector employment growth. On this basis SEZ's are advertised as a major contributor to employment growth. But this is comparing apples and oranges, for, in the context of a single spurt in employment, the comparison point should not be the *annual* rate of employment growth but *total* employment in the country. In this context, even if the fantastic estimates of 25 lakh jobs come true, this is less than 0.5% of the total workforce in India (estimated at 45 crores). Expecting SEZ's to make a major impact on employment patterns in India is thus expecting the impossible.

The next question, as with exports, is whether SEZ employment will contribute towards a change in the nature of employment (at the margins of organised sector employment). Supporters of SEZ's have a tendency to simplify this problem into the question of moving people away from marginal and unproductive agricultural occupations into industrial wage employment, which is inherently seen as progressive. As said above, the number of people who would be affected by such a move – assuming it occurs at all – is a miniscule proportion of the total.

Moreover, EPZ employment is likely to be of two forms: factory-based employment, which may neither be accessible to nor suitable for agricultural workers or displaced farmers, and construction work, where it is likely that the 'jobs' on offer will in fact be in the form of daily wage labour and casual work. There is no guarantee that employment will in fact be formal, organised sector employment. Indeed, even in existing EPZ's/SEZ's, informal employment practices have continued within factory-based work such as the gem industry. Efforts by State governments to exempt SEZ's from the Contract Labour (Regulation and Abolition) Act and the massive violations of that Act by existing enterprises will only worsen this situation.

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<sup>263</sup> Based on data in CII 2006.

Work opportunities for skilled labour may expand in certain industries, such as IT, pharmaceuticals and engineering. However, the expansion of these opportunities will be highly dependent on the new investment in the area and the ability of that investment to find export markets – which, particularly in the case of information technology, are unlikely to continue growing at the present rate. SEZ skilled labour employment will be very vulnerable to swings in the export market, particularly because there is no guarantee that SEZ's will move towards higher value addition over time.

Supporters of SEZ's often argue that removing “labour market rigidities” - i.e relaxing labour laws – will lead to a greater rise in employment. This ignores the fact that widespread violations of these laws are already taking place, and moreover that relaxation of labour laws is only likely to lead to more insecurity of employment. Finally, the institutional structures of SEZ's are such as to make enforcement of labour law and struggles for workers' rights extremely difficult. In such a context, removing whatever little protection exists at present would be dangerous.

Finally, whatever employment is generated should be seen in the context of the displacement and disruption to agriculture that will be caused by planned SEZ's. The Citizens' Research Centre (2007) estimated that current approved SEZ's will result in 1,96,000 agricultural families (both farmers and agricultural workers) losing their livelihoods<sup>264</sup>. Any estimates of employment growth can only be seen as genuine if they take this fact into account, which almost certainly will negate a large part of the employment growth from SEZ's.

### ***Large Revenue Losses and Wider Effects***

One of the final concerns most often cited about SEZ's is the very high revenue loss to the exchequer from the concessions granted to SEZ's. Rao (2007) estimates that over the next 17 years the loss would amount to Rs. 0.45 per rupee invested in infrastructure for single sector SEZ's, and a very high Rs. 3.48 per rupee for multi-product SEZ's. Even if the investment is entirely new and income tax accruals are taken into account, there is still a net impact of Rs. 0.16 for single sector SEZ's and Rs. 1.60 for multi-product SEZ's. Indeed, even if one goes as far as to guess income tax accruals on personal salaries and make liberal assumptions about the taxation of this income, the net impact remains

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<sup>264</sup> Citizen's Research Centre 2007.

negative for more than 15 years<sup>265</sup>. Further, we should note that these losses will come on top of existing losses to export promotion schemes. In 2004 – 2005, these were already resulting in a loss of 41,000 crores – a staggering 72% of customs revenues and 23% of *total* indirect tax revenue of any kind<sup>266</sup>.

Given the scale at which SEZ investment is envisaged, these are not small figures. Similar calculations are presumably the basis of claims by the Finance Ministry that Rs. 1.75 lakh crores will be lost over the next five years. Efforts have been made to criticise this calculation on the basis that it does not incorporate tax revenues from higher investment and incomes, but this is simply untrue: as seen above, even if optimistic assumptions are made, the revenue impact is still very serious.

In effect, SEZ's will be receiving a subsidy, as if they are generating public goods – but in all areas, as we saw above, they are unlikely to do so on a large scale. The overwhelming private real estate interest in SEZ's makes subsidies even more dangerous, as they amount to transferring resources from public investment into speculative and inflationary private sector activity.

This is not the only wider economic impact the SEZ policy may have. A further key criticism that is often raised is distortions in patterns of investment and development in favour of already industrialised and developed areas, a fear that seems to be borne out by the fact that six States – Andhra Pradesh, Gujarat, Haryana, Karnataka, Maharashtra and Tamil Nadu – have received 78% of all formal approvals so far. Maharashtra and Andhra Pradesh alone account for nearly 40% of the approvals granted. These are all relatively developed States with high degrees of existing industrial capacity, and with the partial exception of Maharashtra, they are also highly urbanised States. In short, the SEZ policy is channeling investment towards geographical areas with existing high levels of industry and investment, in a parallel to the sectoral distortion in favour of existing export sectors that was discussed above. This trend is particularly worrying in light of the fact that there is an expectation that the large flow of capital towards SEZ's, as noted above, will have a “crowding out” effect on the ability or interest of capital in investing elsewhere.

The final and perhaps most serious concern is the question of what occurs if SEZ's indeed fail to generate large amounts of additional exports or to draw large numbers of units. Both possibilities are not unlikely. Chandrasekhar (2006) points out that there is a track record in post-liberalisation India of relaxing the terms and conditions attached to liberalisation policies in order to portray them as a

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<sup>265</sup> Rao 2007.

<sup>266</sup> 33<sup>rd</sup> Report of the Parliamentary Standing Committee on Finance (see Bibliography).



“success.” For SEZ's, this could either mean a relaxation in the net foreign exchange requirement or a removal of the imposition of duties on sales of products in the Domestic Tariff Area (i.e the rest of India). Indeed, as pointed out by Dr. U.K. Sen (personal communication), falling general customs duties may well mean that the imposition of duty on goods sold in the DTA is in any case a meaningless condition (thus for instance printed books are already subject to no duty). In either case, the result would be the entry of SEZ units into production for the domestic market.

If this should happen it would have a damaging effect on the competitiveness of existing production for the domestic market, since other producers would not have the advantage of the incentives and tax relaxations that SEZ's have. The result would be a 'snowball' effect – with other sectors demanding equal privileges and incentives, with damaging results for public finances – or an even greater shift of investment into SEZ's. Both would most likely occur. Indeed, it is an oft-cited argument of supporters of SEZ's that the same policies should be applied across the country, and it will not be difficult for the failure of the SEZ's to become a reason for doing precisely that.

## ***Conclusion***

In sum, SEZ's are not likely to achieve many of the economic goals set out for them, even those that traditional EPZ policies aim to achieve. New investment at the current estimated levels is impossible, and therefore such levels would require shifting of existing investments. Exports are unlikely to grow in the absence of any requirement for significant exports and given the WTO bar on export subsidies. Employment will not grow by a significant amount. Revenue losses will be extreme and wider economic effects dangerous. In short, the policy provides too many incentives, on too broad a scale, in a governance and legal framework that binds the hands of Parliament and the Centre but allows a free hand to investor capital.

As with most such policies, some small static gains, such as the creation of some jobs, a rise in a few export sectors (pharmaceuticals, automobiles, etc.) and a one-time general export growth are used to dazzle, while ignoring the resulting economic costs. These include resource diversion, increased external vulnerability, revenue losses, and economic instability caused by rising speculation and the disruptive effects of SEZ competition on the domestic market. Such a wholesale transfer of power to large capital is unviable even within the terms of purely economic measures. In the next chapter, we explore how it forms part of the larger political struggle within the Indian polity.

## CHAPTER VII: THE POLITICAL STRUGGLE AROUND SPECIAL ECONOMIC ZONES

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Since approvals for SEZ's began in 2006, the zones have become the most contentious issue in the Indian polity and the most explosive economic policy initiative in many years. Across northern India in particular, SEZ's have become an issue that inspires huge mass demonstrations, political party splits and violent clashes. A rising death toll and spiraling bloodshed have accompanied these struggles. No other economic 'reform' has seen such a rapid expansion of militant protest and grassroots conflict.

Any exploration of SEZ's has to grapple with the reality of this conflict. Why have SEZ's become so explosive, and why have they become the flashpoint of struggles between the neoliberal 'reformist' elite and a motley coalition of different political formations in different areas?

This chapter attempts to explore different aspects of this conflict, describing first the different groups of actors on the stage and then considering the various issues that they raise. The chapter concludes with an effort to understand SEZ's as a political phenomenon.

### *The Actors in the Conflict*

As discussed in the earlier chapters, the SEZ policy evolved over the last eight years and across both the NDA and the UPA regimes. At the time of the framing of the SEZ Act, it received little political attention and was passed without much Parliamentary debate. Warnings were heard in some of the alternative economic press that labour laws in particular should not be allowed to be suspended in SEZ's, while sections of the neoliberal and financial press advocated suspension. In the course of coordination committee meetings, and on the floor of Parliament, the Left parties opposed any relaxation of labour laws and insisted on the removal of two clauses in the Bill that pertained to these laws – one regarding the Central government's power to modify or withdraw the application of any law to SEZ's (see chapter 5), and the other a clause empowering the State governments to withdraw application of labour laws in SEZ's<sup>267</sup>. Both clauses were amended by the Commerce Minister through amendments in Parliament. With this, the debate over the Act largely ceased.

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<sup>267</sup> Lok Sabha Parliamentary Debates of May 10, 2005, and Venkatesan 2006.

When the debate began again in the summer of 2006, the issues were different. Announcement by State governments of agreements with various SEZ developers were the trigger for the new controversy. The land acquisition involved in these projects, particularly for large multi product SEZ's, sparked off resistance by farmers and the conflict had begun.

There are several major groups of actors in this struggle. Some of them are as follows:

#### *Local Resistance Groups*

In several areas with large SEZ's planned, including Maharashtra (Raigad), Haryana (Jhajjar) and West Bengal (Nandigram), local residents formed resistance committees against planned land acquisition. These are the central actors in the ground conflicts around SEZ's. Participation in these committees is often across political party and other organisational affiliations, and in each area different groups have taken the leadership. Popular support for these resistance committees tends to be very high and cuts across classes as well. The resistance has focused on the question of land acquisition, though it has not remained confined to that issue.

#### *Left Political Parties*

The Left parties in the Left Front – the CPI(M), CPI, Forward Bloc and Revolutionary Socialist Party – have jointly taken a position critical of the SEZ Act. A letter was sent by the parties to the UPA in October 2006 stating a number of concerns with the SEZ Act, particularly the following:

- Transfer of such large areas of land to private parties should not take place, and there should be a ceiling on the area of SEZ's that can be developed by private parties. Any SEZ's larger than that area should be developed by the State governments. Land that is under closed industrial units undergoing liquidation should be unlocked and used for SEZ's and industries in preference to acquiring new land.
- Rehabilitation of displaced people should be done properly and their livelihood security ensured. The Land Acquisition Act and National Rehabilitation Policy should be amended accordingly, and rehabilitation packages included in the SEZ Rules.
- There should be separate caps for multi-product and sector-specific SEZ's, and a ceiling on land area transferred to private SEZ's. SEZ's should be set up through public investment in order to

address regional imbalances as well.

- The processing area of all SEZ's (multi-product and sector-specific) should be at least 50%. 25% of the area should be dedicated to related infrastructure development. The remaining 25% may be used for buildings and commercial complexes.
- There should be clear guidelines on what kind of real estate use is permitted in SEZ's, with residential provision for workers being one requirement.
- Incentives are excessive:
  - Income tax holidays should be reduced to at most 2 years;
  - Incentives to developers should not be provided or should be much less, as there is no export obligation on them;
  - Service tax exemptions are unjustified and should be withdrawn;
  - Tax incentives should not be provided to banking units inside SEZ's.
- The SEZ Rules require the State governments to exempt SEZ's from taxes and to declare them as public utility services. Both of these areas should be left to the States to decide.

Therefore, the SEZ Act and Rules should be amended accordingly.

However, this joint front masks some degree of difference in approach. The CPI(M) is distinctly more supportive of SEZ's than its three partners in the Front, and prior to the joint letter CPI leaders had taken public positions favouring the repeal of the SEZ Act, while the Revolutionary Socialist Party has passed a resolution with the same position.

The other major parliamentary Left party, the Communist Party of India (Marxist-Leninist) Liberation, has also taken a strong stand against the SEZ policy as a whole. The CPI(ML) Liberation has also been active in local struggles against SEZ's, as have been other Left parties' mass organisations in some areas – particularly the All India Kisan Sabha and the Centre for Indian Trade Unions.

#### *Non-Left Political Parties*

The Congress Party is riven by dissent over the issue of SEZ's, with the party's members including both the policy's strongest supporters, particularly Commerce Minister Kamal Nath, and a range of dissent and opposition. As with many economic reform policies, the support appears to be strongest from party leaders in the Central and State governments (though not from all such leaders),

while the party itself is ambivalent and mass leaders in the party are increasingly concerned.

Congress President Sonia Gandhi made her first and till date only major public intervention on the issue at a Congress Chief Ministers' conclave in September 2006, when she made her now famous remarks advising that agricultural land should not be acquired for SEZ's and that compensation and rehabilitation should be done in a fair manner<sup>268</sup>. Within the party as well, there is growing sense that the SEZ's are proving to be a political liability. An internal Congress party report in January reportedly said that SEZ's would lead to conflicts, uneven development and “enclaves of wealth”<sup>269</sup>. However, Congress governments in Maharashtra and Andhra Pradesh are in full support of the SEZ's and have, as we saw in the previous chapter, received the most SEZ approvals so far.

Among other political parties, only the Janata Dal (United) has taken a strong position against the Special Economic Zones Act as such. The party has also declared that their State government in Bihar will neither seek SEZ approvals nor allow any zones within the State. Most of the other smaller parties have either not taken positions on the matter or are implicitly supportive, sometimes choosing to voice their position through their State governments. Regional parties have also however joined many local struggles against SEZ's, as is the case for instance with the Trinamool Congress in West Bengal. The BJP has been mostly silent on the issue overall, though the party's Gujarat state government has been pushing SEZ's in the State on a large scale.

As a side note, many media commentators condemn this 'hypocrisy' of the political parties, criticising them for combining support for the policy when in government (since “there is no alternative”) with “opportunistic” and “populist” opposition in local areas. Parties should be 'courageous' in their support. However, this ignores the fact that there is also “no alternative” in many situations for parties that wish to survive at the grassroots level. In short, such commentators are asking political parties to ignore their voters' interests and views – a rather disturbing argument in a parliamentary democracy.

### *Government Dissenters*

Within the government as well the SEZ policy has triggered opposition from the Finance Ministry and the Reserve Bank of India, on grounds that the policy is excessive and will lead to revenue loss and speculation (see next section). The Rural Development Ministry has also objected to

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<sup>268</sup> Ramachandran 2006.

<sup>269</sup> Roy 2007.

the diversion of large areas of agricultural land.

### *Mass Organisations, Other Political Formations and NGO's*

The SEZ policy has also come under fire from other political formations and NGO's outside the traditional parties. The campaign against SEZ's has been taken up both at the State and national levels by coalitions of non party mass organisations and some NGO's as well, particularly with regard to the question of acquisition and displacement. In many areas these groups are also the main organisers of the local resistance groups.

Finally, in a further demonstration of the increasing centrality of the SEZ issue, the CPI (Maoist) declared in its 9<sup>th</sup> Party Congress that it would oppose SEZ's and fight them in the areas where Maoist organisations are operating.

### ***Issues of Conflict***

The diversity of the opponents of the SEZ policy is itself an indicator that the battle over SEZ's is a complex and multi-faceted conflict. But in broad strokes this conflict has crystallized around two issues. These are not, as explained below, the only points of contention, but for a variety of reasons they have come to occupy the centre stage.

### *Revenue Loss and "Business-Friendly" Policies*

The first major area of debate originated within the government, from sections of the English press, from parts of the corporate world and from international financial agencies. These are institutions and people that are otherwise strongly identified with 'reforms' in the economy, and their criticism of the SEZ policy is thus in a sense surprising.

The essence of this dissent is that the SEZ policy is showering benefits on select companies at the expense of the government, other companies and the need for reforms in the economy in general. The Finance Ministry has, as stated earlier, expressed serious doubts over the massive tax benefits being provided to SEZ's and has objected to the revenue loss it will cause to the government. The Reserve Bank of India has issued notifications that granting loans SEZ developers would be treated as exposure to the commercial real estate sector. This implies that banks will have to allocate a higher amount of capital when loaning money to SEZ developers, as part of RBI's effort to curb rising real

estate prices and reduce speculation in the sector. The RBI has thus made it very clear that it sees SEZ development as probable real estate speculation. Efforts have been repeatedly made to change the RBI position, but that has not occurred yet<sup>270</sup>. Among external agencies, both the IMF and the Asian Development Bank have criticised the tax exemptions being provided. The ADB's position was that, “firms [are] already eager to invest ... Tax breaks may therefore be unnecessary. Second, SEZ tax inducements are expensive and come at a time when government is struggling to provide adequate infrastructure... Third, special tax exemptions always risk opening up loopholes for tax evasion. And fourth, subsidies can undermine both investment and existing firms outside SEZ's.”<sup>271</sup>

Within India's business world as well, there has been criticism of SEZ's. Vipin Agarwal, a vice president with Bharti Airtel, criticised the SEZ's as being too many in number and coming too late in India's growth pattern (by comparison with Chinese SEZ's or Korean and Taiwanese EPZ's). A single SEZ, he argued, is a stronger model than the many SEZ's being pursued by the government<sup>272</sup>. This concern has reportedly been echoed by Rahul Bajaj, head of the Bajaj corporation, as well.

A good summary of the main theme of these arguments was provided in a recent opinion piece in the *Business Standard*. Arguing that the SEZ policy is “business-friendly” and not “market-friendly”, Nitin Desai states that<sup>273</sup>:

If the policy regimes that are to apply to the SEZs are a good idea, they should be made applicable throughout. If they are an attempt to by-pass political constraints they will run into agitations sooner rather than later. Today these protests relate to land acquisition. Tomorrow they will be triggered by the application of more relaxed labour and environmental laws in the SEZs. .... The SEZs involve discrimination and discretion. The discrimination is between the policy regimes that apply to producing units within the domestic tariff area and those within the SEZs. The discretion lies in the case-by-case approval of proposals to set up these SEZs. Both of these involve a significant departure from a market-friendly system. Sooner or later they degenerate into what we politely call rent-seeking by politicians, bureaucrats and their business cronies.

Thus, the main thrust of the arguments from these critics – which we might call the reformist critique of SEZ's – is that a policy based on government-granted exemptions to companies on such a large scale is inherently violative of market principles and therefore should either be moderated or withdrawn. It provides too much discretionary power and ignores the wider reform of the economy.

This position has had its major impact through the interventions of the Finance Ministry and the

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<sup>270</sup> Moneycontrol.com 2007b.

<sup>271</sup> ADB 2007.

<sup>272</sup> Agarwal 2006.

<sup>273</sup> Desai 2007.

RBI, as described above. It has not as yet received the endorsement of any major figure in government outside of these agencies, though it appears to be fast becoming the consensus among reformist economists outside the government. As such it has severely undermined the ability of the SEZ policy to claim the mantle of being a sound economic 'reform'.

### *Displacement and Land Acquisition*

The second and far larger issue is on land acquisition, which has been voiced most stridently by popular forces. Large amounts of land have to be purchased and set aside for SEZ's, particularly multi-product SEZ's, and in several cases it was announced that this would be done by the State governments using the Land Acquisition Act. This in itself was not new, for, in the name of attracting investment, use of acquisition powers for private and industrial projects has been increasing very rapidly over the past decade.

In this context, three factors contributed towards making SEZ's explosive. First was the fact that they came in the wake of the growing struggles against land acquisition in many areas, such as those in Kashipur, Lanjigarh and Kalingangar in Orissa, in Singur in West Bengal or in Bastar in Chattisgarh. These struggles were already leading to violent clashes across large parts of central India. Second, to those affected, SEZ's represented both a continuation of these existing trends and a new twist on them – firstly, simply because of the sheer size of the multi product SEZ's, and secondly because the process was now happening simultaneously in several parts of the country, all justified in the name of providing 'incentives' to big business. The amount of land to be acquired for SEZ's has been estimated at anywhere from 1,00,000 hectares to 1,50,000 hectares<sup>274</sup>. Third, SEZ developers showed a strong preference for flat and rich land close to urban areas - precisely the areas that tended to be most fertile, with strong agricultural economies and powerful farming interests. Whereas most earlier forcible acquisition and accompanying state repression had targeted tribal and marginal areas, now land acquisition was striking at the heart of the agricultural economy.

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<sup>274</sup> Aggarwal 2006 and Citizens' Research Collective 2007.



### *The Constitutionality of Special Economic Zones*

There are some questions regarding the constitutionality of the declaration of Special Economic Zones. The SEZ Act provides only that the State governments should be consulted at the time of declaring an SEZ. However, Article 243G of the Constitution provides that State governments should devolve powers to panchayats for economic planning and social justice, including concerning matters of land (and other subjects in the XI Schedule). Whether or not such plans have been made, for the Central government to override them may be unconstitutional (Menon 2007).

The situation is clearer in Scheduled Areas (areas with predominantly adivasi populations) declared under the Fifth Schedule of the Constitution. In these areas, the Panchayats (Extension to Scheduled Areas) Act, 1996, defines the basic structure of local governance. The Act provides clearly that the "Gram Sabha [village assembly] or the Panchayats at the appropriate level shall be consulted before making the acquisition of land in the Scheduled Areas for development projects and before re-settling or rehabilitating persons affected by such projects in the Scheduled Areas" (section 4(i)). The gram sabha is "competent to safeguard and preserve the traditions and customs of the people, their cultural identity, [and] community resources" (section 4(d)). Further, in the famous 1997 judgment *Samata vs. State of Andhra Pradesh*, the Supreme Court had held that "the word 'regulates' in para 5(2)(b) of the Fifth Schedule to the Constitution ... also prohibits transfer of private or Government's land in such areas to the non-tribals." The Court observed that "The object of Fifth and Sixth schedules to the Constitution... [is] to ensure that the tribals remain in possession and enjoyment of the lands in Scheduled Areas for their economic empowerment, social status and dignity of their person." The Court held that, therefore, the "Executive is enjoined to protect social, economic and educational interest of the tribals" when making decisions on acquisition, leasing and transfer of lands in Scheduled Areas.

Declaring an SEZ in these areas without consulting the panchayat and the gram sabha is hence illegal, and declaring a private-owned SEZ in any Scheduled Area is arguably unconstitutional.

Almost immediately struggles came up against SEZ's, with four projects in particular coming under fire. The first was the Reliance power plant in Dadri, Uttar Pradesh, which drew the involvement of former Prime Minister VP Singh, as well as numerous other mass organisations and solidarity groups. The second was the enormous planned MahaMumbai SEZ in Maharashtra, also by Reliance, which has drawn opposition from across the political spectrum as well as local tribal and Dalit organisations. The third was the Jhajjar SEZ planned in Haryana, by a joint venture between Reliance and the State government, which is slated to be the largest multi-product SEZ in the country. The fourth was the Nandigram SEZ in West Bengal, planned for the Indonesian Salim group. In all four sites, public announcements by the State governments fueled fears by farmers and agricultural workers about imminent land acquisition on the basis of payment of government-fixed compensation rates,

which are almost always far below market rates. The loss of land and the livelihood and food security that it provides also cannot be replaced by any amount of cash compensation.

Despite initial efforts to suppress protests by use of the police, these conflicts soon spiralled beyond the control of the State governments. This level of protest began to draw the attention of both national political leaders and SEZ proponents in the press and the government. A number of remedies have been proposed recently.

#### *Frequently Proposed Remedies to the Acquisition Conflict*

The first proposed 'remedy' is to avoid the acquisition of prime agricultural land, as Sonia Gandhi advocated and Commerce Minister Kamal Nath agreed to. This aims at addressing the problem of loss of agricultural land and consequent problems of food security (which, as noted in chapter 3, are a serious problem in China), while also reflecting the realisation that the involvement of large farmers and landlords in the protests would be politically highly damaging. However, it fails to address the conflict, as it says little about the livelihoods and concerns of the many others who till more marginal lands; and in any case, in many areas, SEZ developers and State governments simply claim that the land is not prime agricultural land at all.

A second remedy is to improve the compensation package offered in rehabilitation. Many argue that the State governments should pay the correct "market rate" and offer some other form of compensation as well. It is of course impossible to justify governments not paying the market rate, but this in itself raises the question of *which* market rate – the market rate for agricultural land or the market rate it would fetch after change of land use has occurred? Similarly, repeated suggestions have been made that companies offer a share in the final project to the displaced, a suggestion that while receiving support from some SEZ proponents has yet to find much favour with the project developers themselves. A third point has been raised by the West Bengal government and the CPI(M), which provided compensation for agricultural labourers and sharecroppers as well as to land owners. Finally, the government has reportedly considered that SEZ developers should be required to ensure employment for at least one member of each displaced family.

But none of these models has improved the situation, in part because it is known that rehabilitation schemes have very rarely worked as advertised and it is extremely difficult for displaced people to hold the state or the company to their commitments – which in most cases have been

flagrantly violated. This has led to increasing clamour for the third proposed 'solution', which is that the State governments should cease using their acquisition powers and leave it to the private developer to purchase the land directly from the affected landowners.

This remedy has a certain apparent neatness to it, particularly from the neoliberal point of view, in that the whole question of compensation is dispensed with, “market rates” are by definition being paid, and there is no sense of police or state forces being used on behalf of a private party. This option has been objected to by some in the press and government on the ground that it is not possible for a private party to deal with purchases of so many pieces of land<sup>275</sup>. Nor is it a favoured option for developers or industrialists, who would naturally prefer State-imposed low land purchase prices, with even these prices often not being paid in full by the private party<sup>276</sup>. But to others, including both strident critics and many in government worried by increasing unrest, it increasingly seems an ideal option. Indeed, in Haryana and Maharashtra, increasing discomfort within the government over land acquisition led Reliance to announce that it would in fact go for direct purchase from farmers. Recent press reports state that the Central governments intend to amend the Land Acquisition Act to this effect as well<sup>277</sup>.

Though this remedy may in some areas be a step forward, it is neither a permanent nor a complete solution. First, as noted earlier, the segmentation of India's land market on the basis of land classification means that direct purchases may hence remain unjust to farmers, and further do not curb speculation. Second, private purchases on a large scale are unlikely to be free of force and coercion – the presence of land mafias all over India is evidence enough of that. Indeed, in a sense it is easier to hold the state accountable than a private purchaser, particularly one with money power; the land market in India is not hardly one of free and voluntary transactions. Third, the private purchase system, in the case of large areas of land, does nothing to address the needs of non-landowners who are also being displaced, such as sharecroppers, tenants, agricultural workers and so on. Their needs will lead to future conflicts.

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<sup>275</sup> See for instance a quote from a government official in Bunsha 2006.

<sup>276</sup> An oft quoted example is the Tata project in Singur, West Bengal, where the company is paying approximately one seventh of the price paid by the State industrial development corporation to acquire the land (Goswami and Sharma 2006).

<sup>277</sup> Ranjan 2007. It is also reported that the Empowered Group of Ministers has decided that State governments should no longer take part in land acquisition for SEZ's.



### *An Example: MahaMumbai SEZ, Maharashtra*

A good example of the struggles around large multi-product SEZ's is the protests held against the proposed MahaMumbai SEZ, planned for a large region of Maharashtra just south of Mumbai. According to press coverage, an internal Congress party report recently described it as a potential “second Nandigram”.

The proposed MahaMumbai SEZ will cover 14,000 hectares (35,000 acres) of land, one third the size of the city of Mumbai itself. Integrating three SEZ's – the existing NaviMumbai SEZ, a joint venture between Reliance and CIDCO, and a new proposed area – the SEZ is expected to include 45 villages and more than 1,000 hectares of forest land. This makes it one of the largest SEZ's in the country.

It is not entirely clear what is planned within the SEZ in terms of industrial or production activity. Frequent press reports make passing references to “hi-tech and service industries such as electronics, contract research, finance, and information technology”, implying that the SEZ will continue to focus on existing export sectors. Yet what both Reliance and press reports have been very clear about is that the main intention of the new SEZ is to create a new 'city' – essentially admitting that real estate remains the reason for the SEZ.

There can be no better example of what the SEZ policy is creating. As the Pen Taluka SEZ Virodhi Shetkari Sangharsh Sanghatan put it in a submission to the Parliamentary Committee on Commerce, “[The] SEZ is an onslaught on livelihoods of thousands of families. We therefore outrightly reject this SEZ; we neither want compensation nor more false assurances... This is not development.”

But most of all and fundamentally, the private purchase system amounts to granting further power still to the private developer and investor – exchanging state-assisted accumulation for direct acquisition by capital. This is hardly progress. The critical issue in this context is thus not *who* acquires the land but the manner in which the decision is made that the land is necessary, the size of the land, and the provisions made for those whose livelihoods will be affected. These political choices are being left entirely to the developer to make.

In this context, it is a slightly positive development that the Rural Development Ministry is reportedly attempting to set up a cell to verify how much land is actually required by SEZ applicants<sup>278</sup>. A far more effective step would be the idea of a land use plan, raised by the Left parties, whereby a democratically decided plan for the use of land and resources is created by the State government. Transfer of land to zones, or indeed for any other use, should then be done in accordance with this plan. It is important to note that, of all the remedies discussed so far, this is the only one that makes any step – albeit a small one – towards democratic decisionmaking with respect to resources, which is the

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<sup>278</sup> Narayan and Guha 2007.

fundamental conflict with respect to the land issue.

### ***Current Events***

In the wake of the rapid pace of SEZ approvals, widespread protests and the Congress party report mentioned earlier, in January the Prime Minister's Office ordered a halt to any further movement on SEZ's. Shortly afterwards the issue of SEZ approvals and the SEZ policy was referred to an Empowered Group of Ministers headed by Defence Minister Pranab Mukherjee. This is despite pressure from some State governments, including Tamil Nadu, Gujarat, Andhra Pradesh and Karnataka, to lift the freeze on grounds of it being a "threat" to investment - with Gujarat going to the extent of claiming that it would halt "job creation" in the State<sup>279</sup>.

Recent news reports indicate that the EGOM has reached a few conclusions. One is to lift the freeze, particularly for those SEZ's that have received final notification (i.e have demonstrated possession of land)<sup>280</sup>. Second, though reports indicated that a cap on SEZ's may be reinstated, reports after the final meeting of the EGOM indicated that this is not the case. Third, the EGOM has reportedly agreed to a ceiling of 5000 hectares for multi-product SEZ's, a ceiling that would in fact affect only four of the 400 approved SEZ projects so far – one of which, the Reliance MahaMumbai SEZ, is already to be split into two to get around the ceiling<sup>281</sup>. Fourth, given the importance attached to rehabilitation in light of the struggles around land acquisition, the EGOM has apparently decided that SEZ developers must guarantee employment to displaced families. Ironically, however, it has been pointed out that whether this will occur is unclear, as the new rehabilitation policy may not cover most SEZ's as it is currently non-applicable to projects of less than 400 acres<sup>282</sup>. Finally, the EGOM has decided that State governments will no longer be allowed to acquire land for SEZ's.

The Commerce Ministry, in the mean time, has issued a new notification making SEZ developers responsible for the rehabilitation of displaced persons "as per the policies of the State government" - a significant change from the existing system, where the State government is responsible. The new notification also reduces the validity of so-called 'in principle' approvals to one year, to reduce possibilities of real estate speculation, and increases reporting requirements for SEZ developers<sup>283</sup>. Meanwhile, while the Finance Ministry is trying to tighten tax exemptions, the

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<sup>279</sup> Moneycontrol.com 2007.

<sup>280</sup> *Business Standard* 2007.

<sup>281</sup> Chatterjee 2007a.

<sup>282</sup> Jain 2007.

<sup>283</sup> *Times of India* 2007.

Commerce Ministry has now liberalised exemptions to allow contractors of SEZ units to also claim them<sup>284</sup>. Thus, a contradictory process continues within the government.

The clashes in Nandigram, particularly the police firing that killed 14 people on March 14<sup>th</sup>, have meanwhile led to a serious rethink among many State governments on SEZ's. The West Bengal government has put all SEZ's on hold, while the Orissa government has dropped plans for a large multi product SEZ in Kalinga Nagar. Haryana and Punjab are reportedly revising their rehabilitation policies, while in Maharashtra, efforts are on to reduce the size of the planned MahaMumbai SEZ.

In short, most of the actions that seem to be under consideration have concentrated on three issues: limiting the size, spread and losses from SEZ's, the issue of rehabilitation and the role of State governments. While the bar on government acquisition is a significant step, it is clear that the approach is one of tinkering with the SEZ policy to limit its political and social fallout, rather than based on any overall perspective on the dispute itself.

### ***SEZ's and Democracy***

To return to the question with which this chapter began: why have SEZ's become such a centre of political conflict? The most popular and almost unconscious reaction of many press commentators has been to equate the SEZ conflict with the issue of land acquisition alone, and to assume that addressing this issue would be sufficient to make SEZ's non-controversial and popular as well.

But this reductionist point of view is incomplete. Certainly the visceral opposition of people to the loss of their land and livelihoods is the most concrete feature of the struggles; but it is not the only one. Opposition to displacement is a struggle that has been going on at an increasing level across India for the last two decades, and while SEZ's are a part of this history, that does not explain why they in particular (among all the other displacement-inducing projects) have become the centre of such a multi-faceted, rapidly growing and violent conflict.

The reality is rather that SEZ's are not just land-based displacement inducing projects. They are, as has been argued throughout this study, aimed at creating a new territory and a new system of government. Many of those who object to SEZ's from the point of view of people's struggles have in fact clearly stated, on a number of occasions, that their objections are not limited to displacement. Thus the Centre for Indian Trade Unions argued that the “implication of some of the rules go far

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<sup>284</sup> *Times of India* 2007b.

beyond this concept of a minimum regulated fiscal regime to a 'self-contained Privatised Autonomous Entity' independent of the laws of the land"<sup>285</sup>. A critic in *Frontline* magazine described the SEZ's as "subversive enclaves"<sup>286</sup>. The memorandum of the struggle groups in Raigad, Maharashtra, goes into more depth<sup>287</sup>:

SEZ's would lead to concentration of wealth, uneven development, jobless growth and an anti-democratic atmosphere... all these provisions would lead to new corporate rule... The present SEZ Act, 2005, and SEZ Rules, 2006, and subsequent state policies grossly negate the ideals of a socialist, democratic republic proclaimed in the Indian Constitution.

In short, the conflict over SEZ's is in large measure driven by the *political* nature of SEZ's as *institutions*. The power structure in Indian SEZ's is a combination of a zone level system of governance that is extremely centralised and a policy-level structure that is completely shifted in favour of big capital. Taking these two points together, the SEZ policy amounts to a clear statement by the government of India that the political system of this country and its institutions are henceforth amenable to sweeping change as per the demands of capital. This is why Indian SEZ's offend classical neoliberals, who argue, as noted above, that this causes favouritism. But it does far more than this. It contradicts the very idea of a country where popular will is to determine regulation of the economy.

An EPZ policy in itself is problematic. But an EPZ policy that promises to create whole territories under business raj wherever businesses may desire, within which the government voluntarily withdraws both itself and the very premise of people's control, defies description. It is this that is so deeply explosive about the SEZ policy. For it is no exaggeration to state that this policy, in its political underpinnings and theoretical content, is incompatible with any meaningful notion of democracy.

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<sup>285</sup> CITU 2006.

<sup>286</sup> Sridhar 2006.

<sup>287</sup> Submission to Parliamentary Standing Committee on Commerce by Pen Taluka SEZ Virodhi Shetkari Sangharsh Sanghatna (i.e Pen Taluka Anti-SEZ Peasants Struggle Union).



If one were to sum up the current Indian SEZ policy in one sentence, it could perhaps be this: the policy fails on every count. It fails the test of logical consistency, with its actual provisions violating its stated goals. It fails the test of economic rationality, granting incentives that exacerbate existing distortions and encourage speculative activity at the expense of production and development. It fails the test of historical reference, taking an already questionable model and exaggerating its most negative aspects. And, most of all, it fails the test of social and political justice, by promoting a conceptual, institutional and political model that is deeply undemocratic.

It is possible on the basis of such a discussion to attempt 'recommendations' for a better SEZ policy. Among the obvious recommendations would be a halt to any further approvals, a revision of the SEZ policy requiring that zones demonstrate clear potentials for benefiting the economy, a bar on real estate operations in zones and so on. Many such demands are currently being made, though with seemingly little impact on the Central government.

But it has been the main argument of this study that such 'recommendations' can at most be palliatives. The flaws in this policy run far too deep to be corrected by small reforms. The SEZ Act is a particularly extreme example of the utter lack of democracy in India's economic structures. Addressing this Act therefore requires far more than damage control measures – it requires a recognition of the need for economic democracy as a crucial concomitant of political democracy, a reality that one occasionally catches glimpses of in discussions of the need for democratically decided land use plans, for instance. What matters is the political nature of industrial policy and its restructuring in favour of democratic control over resources, investment and growth.

What might such a policy look like, and what role would incentives and zone policies have in it, if any? A brief exploration of possibilities could be as follows<sup>288</sup>. A main focus of the new strategy would be on the expansion of the domestic market by a steady rise in wages, social services and public investment. Exports may form a part of the strategy, but not its sole goal. Export production would be built around a targeted socioeconomic policy aimed at expanding certain sectors through a combination of incentives and disciplinary measures, similar to the East Asian pattern discussed in chapter 2<sup>289</sup>. The

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<sup>288</sup> A more comprehensive description of this model can be found in Bhaduri 2006, Rao 2002 or the last chapter in Chandrasekhar and Ghosh 2000a.

<sup>289</sup> Chandrasekhar and Ghosh 2006a.

focus would be on a continuous increase in value addition by integrating steadily larger parts of the production chain, leading to a rise in both labour productivity and wages<sup>290</sup>. The concept of industrial zones might continue, but not as separate political areas with differential institutions and legal regimes. Rather, they would be one part of a wider vision of land use and allocation of resources, which would be decided democratically. Within zones, infrastructure may be specifically provided, but general incentives would not be granted and no other concessions made. Incentives would presumably be based on sector and value addition, with the geographical location of the industry becoming relevant only if deemed necessary for other gains.

However, such ideas are only possibilities. Once it is acknowledged that the need is for democratic *institutions*, it is clear that what is at issue is not policy matters but a political struggle – a struggle that in fact has become the running theme of Indian politics. Among the crucial areas of this struggle are for land reforms and land rights, both for their importance to livelihoods and as a political strategy for the democratisation of control over resources and the elimination of the power of rentier classes. But beyond land reform is the fight for greater democratic control over both resources and decision-making, with economic planning becoming a popular exercise rather than a state and capital-driven one. It is only in these circumstances that any policy, and particularly any investment or export policy, can have a hope of either economic gains or general 'development'. Moreover, without this deepening of democracy, political democracy itself loses much of its meaning.

The current SEZ Act is so fundamentally antithetical to this principle that at the least it must be repealed, or amended in such a sweeping fashion that it would essentially be replaced with another legislation. It is not a formula for economic transformation; it is a formula for rising conflict and violence. The controversy over land acquisition is only the beginning, and many people have already paid for it with their lives. After SEZ's are declared, we are likely to see new waves of disempowerment, impoverishment and subsequent resistance, especially in the larger zones. For many in this country, the story of India's "high growth" and booming stock market has been a story of desperation, loss of livelihoods and brutal repression. SEZ's are now largely seen as one more chapter in this story.

There is many a media commentator and neoliberal economist who would scoff at such a statement, describing it as a populist slogan that overlooks how wonderful economic growth is. They would do well to reconsider. There is a rising tide of resistance and popular anger across large parts of

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<sup>290</sup> Rao 2002.

India, a tide that no amount of statistical sophistry and media hype can any longer obscure. It is visible in the collapse of large parts of central India into armed clashes and de facto civil war, along with the increasing violence that marks our cities and the wave of suicides among once wealthy farmers.

To ignore these signs and push forward with SEZ's is to ignore the writing on the wall. It is a delusion of grandeur, serving the interest of a small minority, indulged in by the ruling class and propagated by a handful of opinion-makers. But it is a delusion for which all of us will pay an ever increasing price.

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