SEZs not the answer to our infrastructure

Without improving governance and public delivery, the private sector can't be competitive

The news about Reliance signing the agreement for a 18,000 hectare special economic zone (SEZ) on the Delhi border with the Haryana government was laced with the spicy comment that this zone will compete with China. Perfect Indian hyperbole: a small enclave, being sniped at already by members of the ruling party itself and a long way to go yet. It reminds me of what I heard in 1995, that with the new telecom policy, India's tele-density will become higher than China's in less than a decade. Not so easy, is it?

India has found SEZs more than two decades after China had successfully put up its first six, mostly on its southern and eastern coast. At that time, around 1984, we were still besotted with export processing zones (EPZs), of which we put up another four in the latter 80s. I have just discovered an article I wrote in 1987, arguing for a privately managed EPZ that will not bother much with providing a different policy regime, but one that will concentrate on the provision of world-class infrastructure and targeted on a particular community of foreign investors. This idea has taken 17 years to fructify!

And yet we do not know if, like EPZs in the past, we will again see domestic investors flocking to these SEZs and foreign investors continuing to be reticent on investing in large volumes. If that happens and SEZs come to provide an infrastructure and tax haven for domestic investors, it will defeat one of their important aims, of attracting foreign direct investment (FDI). And, SEZs will then be seen as either a real estate scam or a tax shelter, or both, and this will not give them a good press. If some states also make labour laws more flexible in the SEZs, as they should if these are to be successful, other domestic investors and the Left could well become strident in their opposition to these zones. In economic terms, too, without net additionality in investment and blanket tax exemptions and concomitant revenue loss, SEZs may not seem the most attractive way to push investments, exports and growth.

The good India story is beginning to attract FDI, as foreign investors try and spread their risks by seeking alternatives to China as about the only FDI destination. The country risk is perceived to have risen significantly as China comes of age and wage costs start to rise. So, FDI could well be directed away from China in coming years. This is becoming clear with Japanese and Korean FDI emerging trends. The question is if Indian SEZs will be able to attract this FDI. This will depend on foreign investors seeing SEZs as contributing to improving the overall investment climate here and effectively removing the binding infrastructure constraints, procedural bottlenecks and emerging skill shortages.

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- When SEZs come up, an underdeveloped environment will still surround these
- It is as sustainable as boring a tubewell because of lack of public supply
- Focus on reforming public delivery, procedures and education to compete

The era of creating enclaves for either policy havens or internationally competitive infrastructure looks increasingly passe, especially when all other countries are rapidly improving their own investment climate and thereby giving far more options to investors. Even when these SEZs come up after two or three years (this reflects my incorrigible optimism), these will still be surrounded by an underdeveloped environment. The possible chaos where the "world's most advanced infrastructure facilities" interface with unchanged Indian realities can be easily imagined.

SEZs represent the attempt to overcome weaknesses in delivery of public goods and services. Seen thus, they represent the same quality of response as boring a tubewell in your backyard or having one's own generator due to non-availability of public water supply or power. Are these sustainable responses? Will they not further exacerbate inequities in the system, with only the richest being able to afford the SEZ facilities, and the large mass of small and medium enterprises having to depend on unsatisfactory infrastructure and other public services? And one can easily see the strengthening of spatial inequalities across Indian states, with the more successful ones cornering the largest share of private investment.

We have all have been thoroughly impressed with the spirit of the Indian private sector, that they will grow and take on international competition, irrespective of getting any help from the government. This spirit saw the Indian entrepreneur remain afloat during the worst days of the license-control raj, and since 1991 we've seen it achieve amazing dynamism. But all over the world, infrastructure has been built predominantly through public investment: private investment only contributes at the margins. The experiment in the 90s, of relying on private investment at the high noon of the Washington Consensus has been seen to be unworkable. It will be difficult for India to be unique in this regard.

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For public investment to yield desirable outcomes and even for attracting private investment, the quality of public governance has to improve. Without focusing on improving governance and, concomitantly, delivery of public goods and services, the Indian private sector may not sustain global competitiveness. The time has, therefore, come to focus far more closely and persistently on improving the delivery of public goods and services, rationalising our procedures and giving education a huge push, rather than spending precious official attention at the highest levels in inter-ministerial debates on the pros and cons of SEZs. Industry, too, will do well to focus on these real issues, rather than continue to believe that growth generated through enclaves will either be sustainable or inclusive.

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