Special Economic Zones and their Impact on Export Promotion

May 17, 2007

Workshop Proceeding

ICRIER organized a Workshop on "**SEZs and its impact on Export Promotion in India**" on 17th May, 2007. The workshop was chaired by Dr. Rajiv Kumar, Director and Chief Executive, ICRIER.

Mr. Sukumar Mukhopadhyay presented the first paper of the workshop, paper enittled "Cost and Benefits of Tax Exemptions for Export Promotion Schemes". He talked about the Drawback, DEPB and EPCG schemes. He then went on to show the figures for duty forgone in the three schemes, and explained that duty forgone is not actually a "cost" of export. All countries follow the policy of zero rating, and hence, if India does not follow this, then we will lose competitiveness in the world market. The other cost is seen as the misuse inherent in these schemes, when imports are done under duty exemptions but exports do not take place.

The paper calculates the subsidy element in these schemes, by comparing between DEPB rates and Drawback rates, for 87 items which can be compared. While assessing the schemes, he explained that exports have not risen after 1997, in the same rate after DEPB was introduced. In the five years from 1991-92 to 1995-96, the average rate of growth was 26.2%. In the next five years after DEPB was introduced, from 1996-97 to 2001-02, the average rate of growth was 11.75%. Thus, the notion that after DEPB, export boomed is wrong. The author also made a projection for the cost of export for the next three years, based on the assumption that the customs duty comes down to 10% and capital goods duty to 7½%.

Some specific suggestions for the three schemes were also spelled out. Mr Mukhopadhyaya's view was that it is worthwhile to continue with some of the schemes with modifications till the duties are lowered enough to make these schemes unattractive. Neutralization of Central Excise Duty is important and for that Rules 18 and 19 should continue. He argued that Drawback should remain and DEPB should be abolished.

The paper was discussed first by **Dr. Satya Poddar**, from Ernst &Young India. He began by outlining the need for export incentives, how they are structured and their impact. Incentives are needed to encourage domestic value-addition and subsidize exports to improve competitiveness. He further said that exports depend on many variables, such as, exchange rate, domestic infrastructure and investment climate, and global economic conditions. He was of the opinion that a simple comparison of export growth before and after DEPB is too simplistic to draw any inferences about its impact. Also, he pointed out that any analysis on export is incomplete without including service exports.

The second discussant was **Mr. R.V Kanoria**, from Kanoria Chemicals Prvt. Ltd. He explained that the "cost of export exemptions" as a percentage of total cost is negligible. So, it is not a major drain on the exchequer. He also said that the transparency of the Drawback schedule needs to be examined. On the author's suggestion of giving a blanket exemption, he commented that the Advance License Scheme was actually a blanket exemption.

This was followed by **Dr. Aradhana Aggarwal** presenting her paper on "SEZs in India : A Quantitative Assessment of Costs and Benefits". The benefits are seen under two approaches: The Orthodox Approach and the Heterodox Approach. She further explained that Export Oriented Industrialization is promoted under three channels: domestic producers, MNCs and clustering. She further said that promoting manufacturing is important in India because India mainly has service-sector driven growth, and the share of manufacturing remains almost constant at 16-17%. The benefits are classified into: direct and indirect benefits. The direct benefits are increased foreign exchange earnings, higher employment generation, employment for females, skill upgradation and FDI inflows. The indirect benefits are in terms of indirect employment generation, investment, skill and technology spillovers.

However there are several costs, namely, SEZ development cost, revenue loss and operational costs. There are other welfare costs, namely, resource transfer from the domestic sector to SEZs with no addition to economic activities, land acquisition without adequate compensation, impoverishment of farmers, loss of agricultural land and other regional disparities. She further made projections for static benefits from 2007-2009.SEZs also contribute to improvement in human development and poverty. Remunerative employment is provided for people with low education level, better working conditions and living conditions. The SEZ Act provides a major thrust to a well balanced package of incentives and infrastructure. The most important ingredient in any SEZ policy is the tax incentives.

She concluded that SEZs can act as catalyst to industrial growth provided they are implemented effectively. However, the SEZ policy should be seen as a transient policy, and the government must also slow down the process of giving approvals. This is important not only for social or political reasons but also due to economic realities. Legal institutions related to land acquisition must be addressed. A performance based exit policy for SEZ developers is also required.

The paper was then discussed by **Mr. Vivek Mehra** of PricewaterhouseCoopers. He first explained that the key concerns about SEZs were land acquisition, revenue loss due to tax exemptions, relocation and diversion of labour etc. However on the basis of estimates from Ministry of Finance, and calculations made thereof, the estimated revenue loss turns out to be much less than the estimated revenue gains. The gains were about five times more than the estimated losses.

The paper was also discussed by **Dr. Kavita Rao** from NIPFP. She is of the opinion that we must look at the benefits generated from SEZs that are over and above the benefits from investment that would have been generated even otherwise in the country. A quantity based analysis of cost and benefits of SEZs does not give the true picture. Also, when dealing with the incremental capital-output ratio, one needs too look at overall country-wise ratios, rather than company wise ratios. She also pointed out some discrepancies in the data used in the paper, especially the ICOR that was used.

The assembled participants put forward several comments after this presentation, the most critical being that one needs to look at a more diversified perspective while assessing SEZs. Too much importance is being given to the export increasing potential of SEZs. SEZs are expected to increase infrastructure, generate employment etc among other things. Also, relocation is not an important issue at times, as many SEZs hire fresh recruits from neighboring local areas. Also, it was pointed out that one needs to focus on the value added by SEZs rather than the total value of SEZs.

It was also commented that the basic difference between the tax exemption schemes and SEZs is the income tax holiday; otherwise they serve the same purpose. So, a comparison of the tax exemption schemes and SEZs is needed. Additionally, comments were made on the fact that none of these schemes takes into account local duties and taxes, turnover taxes etc. There is a need for a transparent mechanism by which the refund of different duties takes place. Another view was that SEZs would succeed only if they concentrate more and more on infrastructural development.