
THE SOCIO-ECONOMIC IMPLICATION OF SEZs

Ishan Thakur, BA LLB, National Law School of India University, Bengaluru

ABSTRACT

SEZs in the developing world is seen as an instrument of development and economic growth. In the Indian context, SEZs have had a divergent trajectory with mixed results when compared to that in China. This paper aims to show that even though the place-based development of SEZs in the initial phase has resulted in inequalities in the short term, with proper policy interventions and state support SEZs have the potential to act as a tool for development and growth in the long-term. The paper provides certain policy suggestions that can aid to achieve balanced regional development and inclusive growth in the long term. The paper attributes the unsatisfactory performance of SEZs in India to several factors such as land acquisition issues, competition between states to attract investors, failure to create linkages between SEZs and local firms, ineffective policy intervention, and failure in creating jobs for low-skilled labours. Further, it emphasizes the importance of policy intervention in order to effectuate proper utilization of spill-overs to achieve positive results in the long term. In conclusion, the paper provides certain recommendations that can help in generating positive results from SEZs in the long term.

INTRODUCTION

From promoting industrialisation to economic transformation, SEZs have been used across the developing world as a policy tool for stimulating socio-economic development.¹ The Indian Parliament enacted SEZ Act, 2005 with the primary purpose of attracting foreign direct investment (hereinafter, FDI), creating jobs, improving infrastructure, and increasing exports.² However, all SEZs established since then have not been successful in achieving the above goals. Some SEZs like the Noida SEZ have fared well in terms of achieving the above-mentioned goals³, while others have not.

Several studies have been conducted, since the first Export Processing Zone (hereinafter, EPZ) was established in Kandla in 1965, to trace the developmental trajectory and policy implications of SEZs in India. Some of these studies have pointed out that ineffective policy intervention, regional disparities, corruption, and land-related issues are some of the reasons why SEZs have not been able to achieve the goals set by the government. Given the fact that the Government of India is planning to revamp its SEZ policy⁴, taking a pause to assess the performance of SEZs, their success in achieving the intended goals, and their socio-economic implications so far becomes all the more important.

In this regard, the researcher argues that in order to make the SEZs work as a catalyst of development and result in positive spill-overs, a clear long-term commitment needs to be adopted. Though place-based development of SEZs may result in inequalities in the short term, with proper policy interventions and support they have the potential to act as a tool for development and growth in the long term. For this purpose, the paper is divided into four parts. Part I will examine the trajectory of SEZ policy and its performance in India. Part II will deal with the resultant socio-economic implications of SEZs development in the Indian context. Part III will analyze how despite the short-term inequalities, proper policy interventions can result in long-term spill-overs from SEZs. Finally, Part IV will provide certain policy suggestions that can help to achieve balanced regional development and inclusive growth in the long term.

¹ Douglas Z. Zeng, *The Past, Present, and Future of Special Economic Zones and their Impact* Journal of International Economic Law 1 (2021).

² The Special Economic Zones Act, 2005; s 5.

³ Babita and N. K. Bishnoi, *A Social Benefit Cost Analysis of Special Economic Zones in India: A Study of Noida SEZ*, Indian Economic Journal 1 (2019).

⁴ *New Legislation to replace Special Economic Zones Act*, (Press Information Bureau, 01 February 2022) (last visited 01 November 2022) <<https://pib.gov.in/Pressreleaseshare.aspx?PRID=1794135>>.

SEZs AS TOOLS OF DEVELOPMENT: THE INDIAN EXPERIENCE

The SEZs, from the time of their adoption, have been promoted as a tool for development and economic growth.⁵ They were supposed to act as models of excellence to be replicated across the country.⁶ This is primarily due to their capacity to generate positive spill-over effects in the form of attracting investment, developing infrastructure, generating employment, and improving the socio-economic situation across the surrounding places of their establishments.⁷ However, several studies have argued that the performance of Indian SEZs and EPZs prior to them has been quite dismal, since their inception, as compared to what was projected. This has been attributed to several factors which need to be studied in order to avoid the same in future policy formulation.

Land laws & related issues

The first hindrance that private developers face is getting possession of land for SEZ development. The complex and diverse nature of land policies across different states aggravated the same.⁸ Here, the role of state government and state development corporations becomes important as they play a major role in acquiring land and making it available to the developers. Further, the developers have no option but to get support from state politicians and bureaucracy to acquire land which raises the chances of corruption.⁹ It becomes all the more important given the fact that, de facto, formal approval is granted only when the developer is already in possession of the land.¹⁰ This highlights how the existing land laws in India act as an impediment to private land assembly.¹¹

The battle between States

The state governments often compete between themselves by offering tax incentives to attract investors. Further, there are state-specific SEZ laws that result in the creation of inconsistent

⁵ Zeng (n 1) 1.

⁶ Amitendu Palit, *Growth of Special Economic Zones (SEZs) in India: Issues and Perspectives* 1(2) Journal of Infrastructure Development 133, 137 (2009).

⁷ Meir Alkon, *Do Special Economic Zones Induce Developmental Spillovers? Evidence from Indian States* World Development 396, 399 (2018).

⁸ Triyakshana Seshadri, *An Analysis of the Feasibility of Private Land Assembly for Special Economic Zones in India* Urban Studies 1, 7 (2011).

⁹ Alkon (n 7) 407.

¹⁰ *ibid.*

¹¹ Seshdari (n 8) 12.

policy frameworks with different goals.¹² However, the excessive focus on offering incentives have resulted in heavy loss to state exchequers. In this respect, lessons can be learned from China's SEZ experience which shows that incentives solely cannot be the solution to all the problems. Instead, the focus should be on infrastructure and institutional development which are necessary prerequisites for extracting positive spill-overs from SEZs.¹³

Linking the SEZs with the local economy

As argued earlier, a long-term commitment is essential for the successful implementation of SEZ policy. This is important given the fact that, in the long run, the goal should be towards linking SEZs with the local economy. The establishment of, what Yuan and Eden call, '*backward linkages*' is critical for the successful transfer of knowledge and technology to the domestic firms located outside the zones.¹⁴ Bangladesh and China are cited as examples where the connection with the local economy resulted in positive spill-overs.¹⁵ However, Indian EPZs failed in establishing such linkages with the rest of the economy due to an '*inward-approach*' followed by the Indian economic outlook initially and policy restrictions.¹⁶ The policy was oriented solely towards creating zones for export promotion with excessive incentives, which resulted in increasing inequalities between firms inside and outside the zones.

Ineffective Policy Intervention

Some scholars have argued that poor policy intervention was one of the main reasons for the unsatisfactory performance of the EPZs that were initially set up in India.¹⁷ Global experience has shown that policy intervention along with continuous monitoring and performance evaluation are important factors for ensuring the success of such zones.¹⁸ The policy intervention plays an important role in the implementation, planning, and management stage. It is important at every stage, from ensuring skill development in labourers to establishing proper supply-chains. The presence of various flaws and loopholes in the proper formulation

¹² Malini Tantri, *India's SEZ Policy – A Retrospective Analysis*, The Institute for Social and Economic Change Working Paper 301, 5 (2013) (last visited 03 November 2022) <http://www.isec.ac.in/WP%20301%20-%20Malini%20L%20T_8.pdf>.

¹³ *ibid*, 14.

¹⁴ Palit (n 6) 135.

¹⁵ Douglas (n 1) 11.

¹⁶ Palit (n 6) 140.

¹⁷ Tantri (n 12) 19.

¹⁸ World Bank, *Policies to enhance participation (World Development Report, 2020)* 185 last visited on 05 November 2022) <<https://www.worldbank.org/en/publication/wdr2020>>.

and execution of policies is therefore argued as a potential reason for the dismal performance of these zones.

Aggravating Inequalities

India has an abundance of low-skilled and unskilled labour and with an increase in the automation of industries, the ability to create sufficient jobs even in the manufacturing sector becomes a concern.¹⁹ Despite this, the fact that one of the aims behind creating SEZ was employment creation, they have not contributed much towards low-skill job creation. The government's policy favoured IT-based SEZs which resulted in a major chunk of zones being IT-dominated.²⁰ Further, they mostly require high-skilled labour, which results in a dearth of opportunities for others labourers, and reinforced the existing inequalities.

PLACE-BASED DEVELOPMENT & UN-UNIFORM URBANISATION: THE INDIAN STORY

So far, the studies conducted on the performance of SEZs in India have shown an inherent bias when it comes to giving approval for SEZs and choosing the location for their establishment.²¹ Scholars have argued a coastal and urban bias when it comes to the choice of location for establishing SEZs. This is due to the presence of an '*agglomeration advantage*' in the form of availability of labour, existing supply-chain mechanisms, and pre-existing infrastructure in these already industrialized regions.²² Global experience is evident in this regard that SEZs seems to prosper in cities with developed ecosystem consisting of an established transport mechanism, operational markets, well-developed infrastructure, and the presence of industries and skilled labours.²³ The investors are also more interested in investing in zones located around developed cities like Bangalore, Delhi, Gurgaon, Mumbai, and Chennai due to which SEZs in India have proliferated around these already developed regions.

¹⁹ PTI, *India unlikely to develop through unskilled labour: ICRIER*, (*The Economic Times*, 05 February 2016) (last visited on 03 November 2022) <<https://economictimes.indiatimes.com/news/politics-and-nation/india-unlikely-to-develop-through-unskilled-labour-icrier/articleshow/50872075.cms?from=mdr>>.

²⁰ Bhuvnesh Talwar, *IT industry reaps the benefits of SEZs & STPIs: other sectors left on the edge*, (*The Economic Times*, 25 February 2012) (last visited on 06 November 2022) <<https://economictimes.indiatimes.com/north/it-industry-reaps-the-benefits-of-sezs-stpis-other-sectors-left-on-the-edge/articleshow/12033060.cms?from=mdr>>.

²¹ Palit (n 6) 143.

²² Yeseul Hyun and Shree Ravi, *Place-based Development: Evidence from Special Economic Zones in India* Boston University-The Institute for Economic Development Working Paper 306 (2018) (last visited on 04 November 2022) <<https://econpapers.repec.org/paper/bosiedwpr/dp-306.htm>>.

²³ World Bank (n 18) 185.

The data portray that more than 75% of SEZs are located in the well-off and most industrialized states. These are the states like Andhra Pradesh, Gujarat, Haryana, Karnataka, Maharashtra, and Tamil Nadu with a higher ranking in most of the developmental parameters as compared to the national average.²⁴ On the other hand, central and north-eastern states are lagging far behind, with big states like UP having far too less number of SEZs and resource-rich states like Assam and Jharkhand having no operational ones.²⁵ The sector-wise distribution, on the other hand, indicates that most export-intensive SEZs are situated in coastal states due to the presence of cheap transportation modes. While IT-based SEZs are mostly present in the southern states.²⁶

Scholars have argued that the place-based development strategy in India has resulted in aggravating disparity between the developed and underdeveloped regions.²⁷ Usually, place-based strategies are used to stimulate development in a backward region. Even, a report by the Comptroller and Auditor General's office has highlighted how the SEZs have grown close to industrialized and urban centers which brings into question the claim regarding SEZs being the tool of regional development.²⁸ However, it needs to be realised that most of this study is based on the performance of Indian SEZs in the last two decades of their existence which at best can be categorised as a short-term period.

International experience suggests that location choice acts as a major determinant for the success of an SEZ.²⁹ In order to generate positive externalities and spill-overs, these zones need access to better connectivity, the presence of skilled labours, and the requisite social infrastructure for functioning effectively. Therefore, in the initial years, the place-based development policy was focused towards these developed regions because they already had the pre-existing infrastructure required to ensure the initial growth prospects of SEZs. Further, if from the beginning the policy was focused towards development in the backward region, it would not have been much success in terms of generation of FDI because location choice also acts as a major influence for investors.³⁰ It also needs to be understood that in 2005, at the time

²⁴ Palit (n 6), 143.

²⁵ Panduranga Reddy, A. Prasad and M. Sampath Kumar, *Balanced Regional Development of India through Special Economic Zones: An Empirical Study* Journal of Social Sciences 1, 11 (2009).

²⁶ *ibid*, 144.

²⁷ Alkon (n 7) 406.

²⁸ Report of the Comptroller and Auditor General of India, 'Performance of Special Economic Zones' (2012-13) 13 (last visited on 06 May 2022)

<https://cag.gov.in/uploads/download_audit_report/2014/Union_Performance_Dept_Revenue_Indirect_Taxes_Special_Economic_Zones_SEZs_21_2014.pdf>.

²⁹ World Bank, (n 18) 185.

³⁰ *ibid*, 185.

of the inception of SEZ Act, the economic, political, and social context of India was much different as compared to the present when India is among the top five economies of the world. Back then, if the place-based development was focused on the underdeveloped or backward regions, the policy might not have been able to generate the positive results it has generated so far.

Other studies have also highlighted that when it comes to SEZs, a ‘one-size-fits-all’ approach has often proved to be detrimental.³¹ It has been emphasized that policy intervention becomes important here as SEZs need to be fitted according to the existing local conditions. China, which is often cited as the pinnacle of success when it comes to SEZs, has also followed a long-term phased policy in developing specific SEZs. Initially, they focused on developing the requisite infrastructure, diversifying industries, skill development of labours, and technology infusion in a step-by-step manner.³² In the Indian context, the Noida SEZ acts as an important example in this regard which shows how the right policy intervention in the form of developing superior infrastructure, providing favourable business conditions, right incentives, and solving market imperfections can help to generate positive gains in the form of spill-overs from SEZs.³³

SHORT-TERM INEQUALITIES AND LONG-TERM SPILL-OVERS

Spill-overs are defined as positive or negative effects generated as a result of the development of these zones in specific areas.³⁴ They are generally in the form of socio-economic outcomes which can be used by the government for the development of backward regions in the country. The positive externalities can be in the form of enhancement in workers' skills, employment generation in ancillary businesses, and transfer of technology to domestic firms. Similarly, the negative externalities are the environmental impact, natural resources degradation, and loss of traditional sources of employment.³⁵

The spill-overs can be categorized into three categories.³⁶ The first ones are economic in nature and are generated in the short term in the form of local employment, investment in domestic firms, and an increase in exports. The second kind comprises long-term structural changes in

³¹ Doughlas (n 1) 3.

³² Tantri (n 12) 17.

³³ Babita and Bishnoi (n 3) 11.

³⁴ Susanne Frick and Andrés Rodríguez-Pose, *Are special economic zones in emerging countries a catalyst for the growth of surrounding areas?* 26 *Transitional Corporations* 75, 77 (2019).

³⁵ Palit (n 6).

³⁶ Frick and Pose (n 34) 77.

the form of skill up-gradation, technology transfer, and an increase in innovation. The third category of spill-overs is in the form of socio-economic impacts in the form of an increase in women's employment, improvement in workers' conditions, and proper compensation and rehabilitation mechanism.³⁷

However, proper utilisation of the spill-overs requires government intervention in the form of creating linkages and providing the necessary policy environment. The spill-overs are transferred through backward and forward linkages which act as necessary mediators.³⁸ This depends on the interaction between SEZs firms and domestic firms for which a conducive atmosphere needs to be ensured by the government. As stated above, one of the reasons for the failure of initial EPZs and SEZs in the last two decades is the absence of the creation of linkages between SEZs and the rest of the local economy. The example of the Noida SEZ highlights that the firms often buy raw materials from international markets instead of local ones because of the differences in prices. The local ones are quite expensive which results in the unavailability of inputs at competitive prices in the local markets.³⁹ However, proper and timely policy intervention can help to create a local business-friendly environment in the form of lower tariffs on imports from domestic markets, and it will go a long way to create strong linkages and ensure proper utilisation of the spill-overs.

Furthermore, the utilisation of spill-overs also depends on, what is known as, the absorptive capacity of the local industries and workforce.⁴⁰ Again, the government act as a major facilitator in this regard. Studies have shown how the absence of governmental incentives for collaboration between multinational and local firms in Ghana has acted as a hindrance to a potential transfer of knowledge and technology to the local economy. The gap in skill and knowledge of workers was a major reason behind the same.⁴¹ Global experiences have also shown that the effects of spill-overs increase exponentially when the zones are located closer to developed and larger markets. In contrast to zones in backward regions, closeness to larger markets has resulted in the generation of greater employment opportunities along with increasing productivity and working conditions of the workers. Further, this has helped to create employment in ancillary industries like construction, hospitality, and trade. There is another effect of positive externality as the proper functioning of zones requires the development of

³⁷ *ibid*, 77.

³⁸ Tantri (n 12) 10.

³⁹ Babita and Bishnoi (n 3) 4.

⁴⁰ Frick and Rose (n 34) 77.

⁴¹ *ibid*, 79.

roads, transportation systems, and other infrastructure along with access to amenities like uninterrupted electricity and water supply.

Therefore, it is argued that even though SEZs in India have resulted in inequalities, as highlighted by some of the studies, these are only short-term effects. The spill-overs generated from existing SEZs if utilised properly through timely policy intervention can help to reduce the existing regional disparities in the long term. This can be done by combing various governmental policies like Skill India Mission, National Infrastructure Pipeline (NIP), Make in India, and Aatma Nirbhar Bharat along with SEZ policy. A policy like Skill India and NIP can be used for the development of skills and infrastructure in backward and underdeveloped regions. Further, Make in India and Aatma Nirbhar Bharat can be used for promoting innovation and growth in local industries. This is essential in the long term for the creation of linkages between foreign and local firms.

REDEFINING THE INDIAN SEZ POLICY: THE WAY FORWARD

As argued above despite short-term inequalities, if the spill-overs generated through SEZs are utilised in a proper way through policy-backing, they have to potential to generate positive developmental and growth effects even in the backward regions. Given the fact that the Central government is considering revamping the SEZ Act, the paper suggests certain measures which if adopted can help to generate positive externalities in the long term.

Firstly, as argued above, a long-term commitment along with proper planning and subsequent implementation is necessary to ensure the successful accomplishment of the objectives of SEZ policy. In this regard, various government schemes need to work in conjunction with a proper timeline. Proper and timely policy intervention is necessary from the stage of approval to the planning of proper utilisation of spill-overs.

Secondly, as shown through the above analysis SEZs in India so far are dominated by the IT sector which mostly requires high-skill labour, therefore focus now should be on establishing multiproduct and export-oriented SEZs to cater to the needs of low-skilled labourers that are in abundance in India. Further, a target-based approach needs to be adopted to explore the avenues for setting up SEZs for unconventional industries like handicraft products in which India has a comparative advantage.

Thirdly, the programs like Skill India Mission should be used towards developing the skills of youth and others in the rural and backward regions. Further, the recently introduced NIP should be utilised for the development of infrastructure, and improve connectivity and transport mechanisms in underdeveloped regions. This is necessary to ensure proper utilisation of spill-overs towards reducing regional disparities.

CONCLUSION

In conclusion, the paper was aimed towards highlighting that with the help of proper and timely government intervention, the spill-overs generated through SEZs can be utilised for the development of backward regions and reducing regional disparities. Further, it argued that though SEZs in India may have generated inequalities in the short term, a long-term commitment with proper planning and implementation is necessary in order to ensure their success. However, this needs to be done keeping in mind the socio-economic implications of such developmental policies.