

## Special Economic Zones in India – An Introduction

Jona Aravind Dohrmann

### Summary

This introductory article describes the salient features of the Indian embodiment of the model Chinese SEZ, how it evolved and what the various steps are in making an Indian SEZ function: from submitting an application and receiving a Letter of Approval for the establishment of an SEZ to getting the authorised operations and particular units sanctioned. The SEZs are tax-free enclaves for investors from India and abroad. As the Prime Minister of India, Dr. Manmohan Singh, said: "SEZs are here to stay". The Indian government and the state governments are now finding that it is not enough to promulgate modern laws luring foreign direct investment into India, but that they also have to provide for the concerns and the livelihoods of those affected by the establishment of SEZs.

"The current promotion of SEZs is unjust and would act as a trigger for massive social unrest, which may even take the form of armed struggle."

*Vishwanath Pratap Singh, former Prime of India, in: Frontline, 20 October 2006*

### 1 Introduction

Lately, India, or at least its economic growth, seems to be on everybody's agenda the world over. Its economic development particularly fires the imagination of Indian and foreign investors. This has led to books being published with titles like "Global Power India" or slogans like "China was yesterday, India is today". Many institutions such as the Indo-German Chamber of Commerce or various consulting companies in Germany sing the Indian tune and recommend doing business in the subcontinent. What to companies and investors may seem to be a vast new horizon for investment offering a plethora of opportunities, is not necessarily welcomed unanimously in India. The development of Special Economic Zones (SEZs) is one element in this vein which is currently leading to a great deal of conflict between various actors, be they political or societal. This is all the more interesting as India was certainly not known as a country that inspired foreign investors. After India's independence in 1947, the Indian government under the leadership of its first prime minister, Jawaharlal Nehru, and with the help of the planning skills of one now forgotten Prasanta Chandra Mahalanobis, a Cambridge-trained physicist and statistician, ushered a planned economy in where the "commanding heights" were to be occupied by the government. Liberalisation was a far cry and not the demand of the day, not even for the industrialists who drew up the so-called "Bombay Plan". In

1944, in anticipation of independence, leading industrialists issued what they called “A Plan of Economic Development for India”. In the early stages of industrialisation, industrialists such as the illustrious J. R. D. Tata and G. D. Birla said it was necessary that “the State should exercise in the interests of the community a considerable measure of intervention and control”, where “an enlargement of the positive as well as the preventative functions of the State is essential to any large-scale planning”.<sup>1</sup> This was an expression of the then prevailing *Zeitgeist*, which was immediately fostered by the Directive Principles of State Policies<sup>2</sup> in the Indian Constitution promulgated in 1950 whose Art. 39 lit. b mandated the state to ensure that “the ownership and control of the material resources of the community are so distributed as best to subserve the common good”. But – as deplored on TATA’s official website<sup>3</sup> – the government under the leadership of Nehru did not heed the advice regarding a low-key approach to large-scale planning. Within a month of the adoption of the Constitution, the government had set up a planning commission to carry out the Directive Principles. Since 1951/52, India’s economic policies have been laid down in the seemingly socialistic Five-Year Plans. What followed was the heavy industrialisation of the Indian economy through international cooperation in places such as Durgapur (West Bengal), Rourkela (Orissa) and Bhilai (Madhya Pradesh). In these locations, steelworks were set up with the help of the British, Germans and Russians respectively in order to produce the output required to provide input to other planned industries. India’s Five-Year Plans were an evocation of the nationalist model of *swadeshi*, or self-reliance, for a long time. As *Guha* puts it:

“Once, Gandhian protesters had burnt foreign cloth to encourage the growth of indigenous textiles; now, Nehruvian technocrats would make their own steel and machine tools rather than buy them from outside. (...) Self-reliance, (...), became the index of development and progress. From soap to steel, cashew to cars, Indians would meet their material requirements by using Indian land, Indian labour, Indian materials and, above all, Indian technology.”<sup>4</sup>

Striving for self-sufficiency thus became the hallmark of Indian economic policies. In the end, the planning policies led to low GDP growth of about 3.6 per cent per annum between 1956 and 1975, which was derisively called the “Hindu rate of growth”. The years after Independence under Nehruvian leadership were also known as the “lost years” economically. But with hindsight, it is to be conceded that India’s approach was much in line with the prevailing notions of development policies or were even demanded by foreign moneylenders, including the World Bank.<sup>5</sup> The planners thought that India, despite its poverty and its technological backward-

<sup>1</sup> Memorandum Outlining a Plan of Economic Development for India (Parts One and Two), Harmondsworth: Penguin Books, 1945.

<sup>2</sup> Regarding Directive Principles of State Policies, cf. Dohrmann (2002), Directive Principles of State Policy in der indischen Verfassung (in German).

<sup>3</sup> [http://tata.com/tata\\_sons/media/20040304.htm](http://tata.com/tata_sons/media/20040304.htm) (last viewed on 12th July 2007).

<sup>4</sup> Guha (2007): 209.

<sup>5</sup> Stangl (2002): 256.

ness, would catch up with the Western industrial nations within a span of three decades. Obviously, this was not to be. The much desired trickle-down effect, meaning that benefits derived from industrial development and overall growth would gradually descend to the poorer sections of society, failed to appear. At first, precious little was done to change policies. Loans were availed of in the 1980s, which, although resulting in growth, fired inflation. Then, in 1991, when foreign transfers from the Gulf region dried up due to the Iraqi invasion in Kuwait and the ensuing war, Indian GDP dropped to a mere 1.3 per cent. India's ensuing near-insolvency prompted the government to ask the World Bank for loans, which, in turn, now demanded liberalisation of the Indian market. The "licence raj", or the rule of permits, was considerably reduced by the new government under the then Finance Minister Manmohan Singh who today heads India's government as the Prime Minister. Tariffs were lowered and foreign investment eased. Shares of more than 50 per cent were allowed. Still, India lagged behind China. Its relationship with China has always been an ambiguous one. Nevertheless, China's achievements in terms of material development have been a sort of benchmark for political actors in India. The country's share of the world's foreign trade, which had never exceeded one per cent, had plunged to below half that proportion, letting originally trailing China surpass the Indian economy. China is still ahead, accounting for around four per cent of the world's trade, but the Indian media never fails to point out that "the Indian Elephant", although more unwieldy, is certainly going to close in on if not overtake the "Chinese Dragon" at some point. One means of achieving this goal is supposed to be by attracting as much FDI into India as possible. At the same time, India has to provide a reasonably well-functioning infrastructure in line with modern standards. A simple equation shows just how far India is still lagging behind China. According to Jha, China built 41,000 kilometres of modern roads of an international standard in five years starting in 1998, which came to 22 kilometres per day. In the same span of time, India built a mere 3.2 kilometres of a vastly inferior road network.<sup>6</sup> The power supply situation is possibly even worse. Load shedding not only has to be borne in the villages of India (although villagers carry the brunt of it), but also in comparatively large cities such as Nagpur, home to about 2.5 million people, where summer power cuts lasting six hours are not uncommon. After having visited China and one of their Special Economic Zones (SEZs), the previous Commerce and Industry Minister's answer to this was to improve the climate for exports with FDI in mind – as he realised the need for a level-playing field to be made available to the domestic enterprises and manufacturers for India to be competitive globally – as well as enhancing the infrastructure, also in hitherto underdeveloped regions of India. Since 2000, the government has been seriously thinking of promoting Indian Special Economic Zones, which the aforementioned Minister, Mr. Murasoli Maran, once described as "our best dream projects" and as "magnet and

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<sup>6</sup> Prem Shankar Jha, India: The Challenge of the Future, in: Voll, Klaus/Beierlein, Doreen (2006): 580.

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glue – [a] magnet to attract FDI and glue to identify and bind strategies that will benefit a large number of people and organisations".<sup>7</sup>

## 2 Salient features of an SEZ

An SEZ is a geographically demarcated region that has economic laws that are more liberal than the country's typical economic laws and where all the units therein have specific privileges. SEZs are specifically delineated duty-free enclaves and are deemed to be foreign territory for the purposes of trade operations, duties and tariffs. The principal goal is to increase foreign investment. Through the introduction of SEZs, India also wants to enhance its somewhat dismal infrastructural requirements, which, once they have been improved, will invite even more foreign direct investment. Or put in the government's own words, the main objectives of the SEZs are:

- (a) generation of additional economic activity;
- (b) promotion of exports of goods and services;
- (c) promotion of investment from domestic and foreign sources;
- (d) creation of employment opportunities;
- (e) development of infrastructure facilities.<sup>8</sup>

### 2.1 New field of research

As the Special Economic Zones are a new feature of Indian economic policy, promulgated in legal terms as late as 2005, no comprehensive research exists into this field as yet. Newspaper articles on SEZs are almost being published on a daily basis – in national as well as regional papers. Courts have become cognisant of the conflict potential concerning the acquisition of land for SEZ sites and promotion of SEZs in the country.

Special Economic Zones have been established in several countries, including the People's Republic of China, Iran, Jordan, Poland, Kazakhstan, the Philippines and Russia. North Korea has also attempted this to a degree, but failed. Currently, Puno in Peru has been earmarked to become a "Zona Economica" by its president, Alan Garcia. In the United States, SEZs are referred to as "Urban Enterprise Zones". Germany also saw discussions regarding SEZs quite recently. The deliberations here aimed at assessing whether there could be an entirely different business environment in some parts of the "New Bundesländer" with regard to the tax regime, bureaucratic exigencies for investors and remuneration regulations. The lacunae in produc-

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<sup>7</sup> As quoted in: Exim Policy – Expecting Too Much, in: Economic and Political Weekly (2002): 1,296.

<sup>8</sup> Taken from the introduction to Special Economic Zones in India: <http://www.sezindia.nic.in/HTMLS/about.htm> (last viewed on 12th July 2007).

tivity and the deficiency as an economic site and its investor-friendliness were to be enhanced by these measures.

## 2.2 Genesis and salient features of an Indian SEZ

Worldwide, the first known instance of an SEZ seems to have been an industrial park set up in Puerto Rico in 1947 to attract investment from the US mainland. In the 1960s, Ireland and Taiwan followed suit, but in the 1980s China made the SEZs gain global currency with its largest SEZ being the metropolis of Shenzhen. From 1965 onwards, India experimented with the concept of Export Processing Zones (EPZ). These did not quite deliver as much as was expected, however. Thus, in 2000, the new Export and Import Policy allowed for SEZs to be set up in the public, private or joint sector or by state governments. Eight EPZs were converted into SEZs. Altogether, a total of 19 SEZs were established prior to the promulgation of the SEZ Act, which were later – in 2005 – legally deemed as SEZs under the new Act. More than 300 SEZs have obtained either formal or “in principle” approval over the years. SEZs have been enabled with a view to providing an internationally competitive and hassle-free environment for exports. Units may be set up in SEZs for manufacturing goods and rendering services. All the import/export operations of the SEZ units are on a self-certification basis. Sales by SEZ units in the domestic tariff area are subject to payment of full custom duty and to the import policy in force. Furthermore, offshore banking units may be set up in the SEZs. The salient features of the Indian SEZ initiative further include the following points:

- Unlike most of the international instances where zones are primarily developed by governments, the Indian SEZ policy provides for development of these zones in the government, private or joint sector. This is meant to offer equal opportunities to both Indian and international private developers.
- 100 per cent FDI is permitted for all investments in SEZs, except for activities included in the negative list.
- SEZ units are required to be positive net foreign-exchange earners and are not subject to any minimum value addition norms or export obligations.
- Goods flowing into the SEZ area from a domestic tariff area (DTA) are treated as exports, while goods coming from the SEZ into a DTA are treated as imports. In addition to the duty exemptions, the units in the Indian SEZs do not have to pay any income tax for the first five years and only pay half their tax liability for the next two. SEZ developers also enjoy a 10-year “tax holiday”. The size of an SEZ varies depending on the nature of the SEZ. At least 50 per cent of the area of multi-product or sector-specific SEZs must be used for export purposes. The rest can include malls, hotels, educational institutions, etc. Besides providing state-of-the-art infrastructure and access to a large, well-trained and skilled workforce, the SEZ policy also provides enterprises and developers with a favourable and attractive range of incentives.

- Facilities in the SEZ may retain 100 per cent foreign-exchange receipts in Exchange Earners' Foreign Currency Accounts.
- 100 per cent FDI is permitted for SEZ franchisees in providing basic telephone services in SEZs.
- No cap on foreign investment for small-scale-sector reserved items which are otherwise restricted.
- Exemption from industrial licensing requirements for items reserved for the small-scale-industries sector.
- No import licence requirements.
- Exemption from customs duties on the import of capital goods, raw materials, consumables, spares, etc.
- Exemption from Central Excise duties on procurement of capital goods, raw materials, consumable spares, etc. from the domestic market.
- No routine examinations by Customs for export and import cargo.
- Facility to realize and repatriate export proceeds within 12 months.
- Profits allowed to be repatriated without any dividend-balancing requirement.
- Exemption from Central Sales Tax and Service Tax.

The incentives for developers of SEZs include:

- Exemption from duties on import/procurement of goods for the development, operation and maintenance of SEZs.
- Income tax exemption for a block of 10 years in 15 years.
- Exemption from Service Tax
- FDI to develop townships within SEZs with residential, educational, health-care and recreational facilities permitted on a case-by-case basis.

### **2.3 Legal framework**

For a long time, the foreign economic policy was formulated in para. 7.1 of the Foreign Trade Policy, according to which (1) SEZs are duty-free enclaves within the territory of India, and where (2) goods and services going into an SEZ from a domestic tariff area (DTA) shall be treated as exports, while goods coming from the SEZ area into the DTA shall be treated as if these are imported; and (3) the SEZs may be set up for the manufacture of goods or rendering of services. Since the SEZ Act of 2005 was put into force, these policies have been outlined there.

As the Indian government wanted to give a significant thrust to its professed investor-friendly policy, the government enacted the SEZ Act, 2005, which became operative in February 2006 together with the SEZ Rules. The state governments followed suit and also enacted their own SEZ laws to mainly cover state subjects. The SEZ legal framework intends to provide a comprehensive tool to satisfy the re-

quirements of all principal stakeholders in the SEZ: the developer and operator, occupying enterprises, external SEZ suppliers and residents. Furthermore, the SEZ Act is advertised by the Indian government as a single window clearance mechanism in which the responsibility for promoting and ensuring the orderly development of the SEZ is assigned to the Board of Approval (BoA). The Board of Approval was constituted by the Central Government in exercise of the powers conferred under the SEZ Act. All the decisions are taken in the Board of Approval by consensus. The Board of Approval has 19 members (sec. 8 SEZ Act). It comprises various joint secretaries and other officials from several ministries, such as the Ministries of Commerce, Economy, Science and Technology, Home Affairs, Defence, Environment, Law, Overseas Affairs, Urban Development and Finance as well as that of a nominee of the state government concerned, a professor at the Indian Institute of Management or the Indian Institute of Foreign Trade. Thus, this Central Government institution is the major authority for applications and approvals regarding the establishment of SEZs. Earlier on, the Central Government wanted to dispense with the right of the states to have a say in the approval procedure. This predictably, on the pressure of the states, had to be revoked, so as to safeguard the support of the left-wing parties in the Indian Parliament, which tolerates the minority coalition government led by the Indian National Congress.

#### 2.4 Who can set up an SEZ and what requirements are there?

An SEZ can be set up jointly or individually the Central Government, a state government or any other body, including a foreign company, for the purpose of (1) manufacturing goods, (2) rendering services, (3) for both of these reasons or (4) as a Free Trade and Warehousing Zone (FTWZ). The SEZ Rules specify the minimum land area that is required for setting up an SEZ in general. This requirement depends on the type of SEZ to be established:

**Table 1: Minimum contiguous area requirements for certain types of SEZs**

Type of SEZ	Hectares
Multi-product (sec. 5 para. 2 lit. a) SEZ Rules)	1,000 or more
Sector-specific or in one or more services or a port or an airport (sec. 5 para. 2 lit. b) SEZ Rules)	100 or more
Sector-specific: electronics hardware or software, IT, gems & jewellery, bio-technology, non-conventional energy, including solar energy equipment and solar cells (sec. 5 para. 2 lit. b) proviso 1 and 2 SEZ Rules)	10 or more
Free Trade & Warehousing Zone (FTWZ) (sec. 5 para. 2 lit. c) SEZ Rules)	40 or more

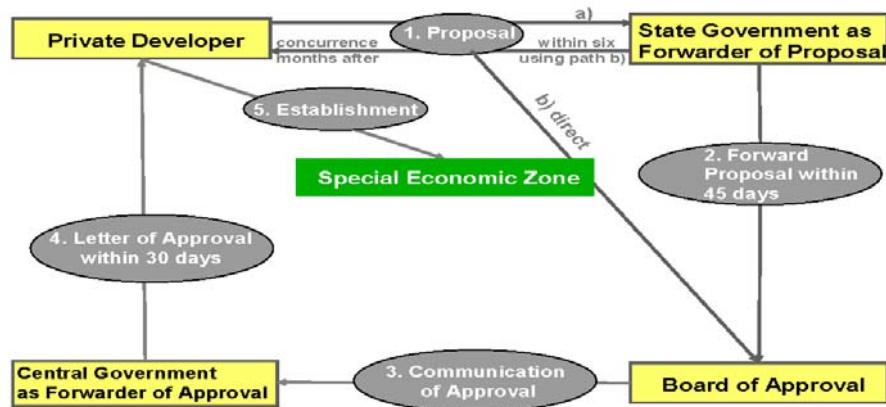
The requirements concerning the minimum size of an SEZ are relaxed with regard to certain small states. Thus, in the states of Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Manipur, Tripura, Himachal Pradesh, Uttarakhand, Sikkim,

Jammu and Kashmir, Goa or in a Union Territory, the minimum area requirement for multi-product SEZs or a sector-specific SEZ has been reduced to 200 and 50 hectares or more respectively. In the case of a multi-product or a sector-specific SEZ, at least 50 per cent of the area must be earmarked for developing the processing area. The very specific requirements for sector-specific operations can be seen from sec. 5 para. 2 lit. b) and c) SEZ Rules. If the developer proposing to set up an SEZ is not in possession of the minimum contiguous area, the Central Government may approve more than one developer. In such cases, each developer shall be considered as a developer in respect of the land under its possession. Whereas, at first, there was no ceiling regarding the maximum size of an SEZ, a meeting of the so-called Empowered Group of Ministers (EGoM) held on 5<sup>th</sup> April 2007 brought about a capping at 5,000 hectares, which can still be undercut by states as land matters are state matters according to Indian constitutional law.

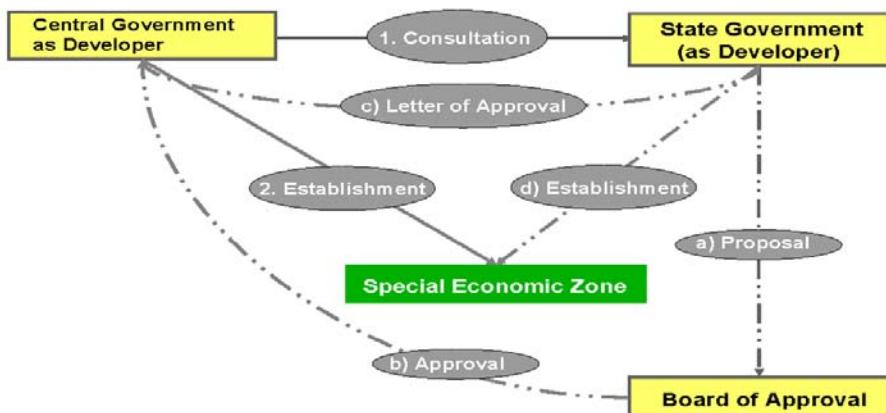
## 2.5 Approval mechanism

The developer, which may be the (Central and state) government itself, a private developer or a joint venture in which both parties are involved, is entitled to set up an SEZ after identifying the proposed area. The procedure for setting up a zone like this may vary according to the nature of the developer. The private developer submits his proposal for establishment of an SEZ to the state government concerned (sec. 3 para. 2 SEZ Act). Notwithstanding, the private developer may also approach the BoA directly (sec. 3 para. 3 SEZ Act) and thereafter get the concurrence of the state government concerned. The state government has to get its proposal screened directly by the BoA according to sec. 3 para. 4 SEZ Act. After consulting the respective state government, however, the Central Government may set up and notify the SEZ *suo motu* (sec. 3 para. 4 SEZ Act). The state government has to forward the private developer's proposal to the BoA within 45 days of the date of receipt along with its recommendation (sec. 4 para. 1 SEZ Rules). The BoA then has the power of approving or rejecting the proposal or modifying such proposals for the establishment of SEZs. In the event of approval, the BoA communicates the same to the Central Government, which, in turn, grants formal approval to the developer (sec. 3 para. 10 SEZ Act) through a Letter of Approval (LoA) within 30 days of receiving the communication from the BoA. The LoA is valid for a period of three years, during which the developer must take all necessary steps to ensure implementation of the approved proposal. The powers also include the decision-taking regarding authorised operations to be carried out in the SEZ by the developer as well as granting approval to the developers or units in the SEZ for foreign collaboration, foreign direct investment and regarding infrastructure facilities (sec. 9 para. 2 SEZ Act). The proposal paths are visualised in Figures 1 and 2:

**Figure 1: Approval mechanism for the establishment of an SEZ for a private developer**



**Figure 2: Approval mechanism for the establishment of an SEZ for the Central and state government as a developer**



Regarding the overall establishment of an SEZ, one has to differentiate between various processes. The aforementioned process describes the steps involved in an SEZ approval. After introducing the other official agencies, which is necessary to understand the further procedures in the SEZ framework, the other procedures that are required to get the SEZ notified in order to acquire a grant of approval for

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authorised operations and for setting up a unit in the SEZ shall briefly be outlined (see Tables 2 to 4).

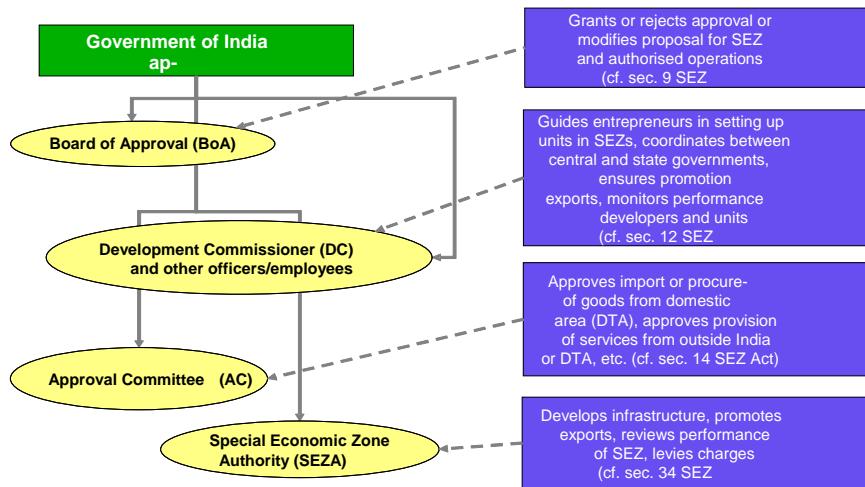
## 2.6 Administrative structure of an SEZ

To devolve its powers to the SEZs, the BoA may delegate the aforementioned powers to one or more Development Commissioners on the Zone level (sec. 9 para. 4 and sec. 12 SEZ Act). The Development Commissioner is the “governor” of the particular Zone or Zones assigned to him, as it were. According to sec. 12 para. 3 SEZ Act he is required to be in charge of the SEZ and to exercise administrative control and supervision over the officers and his assistant employees. He is directly responsible to the Central Government. The Development Commissioner is also something like a link person between the Central and the state governments. *Inter alia*, he is required to guide the entrepreneurs in setting up units in the SEZ and to ensure and take suitable steps for the promotion of exports from the SEZ. Furthermore, he has to monitor the performance of the developer and the units in the SEZ (sec. 12 SEZ Act). At Zone level, presumably below the Development Commissioner,<sup>9</sup> there is the Approval Committee, of which the Development Commissioner is an *ex officio* member. This committee basically has to approve, reject or modify proposals for setting up SEZ units, i.e. to approve the import or procurement of goods from the domestic tariff area or outside India as well as approving the provision of services by companies from outside India or the DTA. The utilisation of goods or services or warehousing or trading in the SEZ has to be monitored by the Approval Committee. Upon former approval by the Development Commissioner, it can also allow foreign collaborations and FDI for setting up a unit, including investments by people outside India. The developer or entrepreneur is responsible to the Approval Committee for complying with conditions set forth in the Letter of Approval or permission (sec. 14 SEZ Act). The Development Commissioner is what the state government and the BoA are on the national level, but at the Zone level. This means that any person intending to set up a unit for carrying out authorised operations in the SEZ has to submit a proposal to the Development Commissioner, who then forwards the same to the Approval Committee. The Committee then decides on the application (sec. 15 SEZ Act). It also has the power to cancel the Letter of Approval if the proposal contravenes the terms and conditions in it. Applications for offshore banking have to be made directly to the Reserve Bank of India, which can specify the terms and conditions subject to which an offshore banking unit may be set up and operated in the SEZ on its own.

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<sup>9</sup> The SEZ Act does not mention anything here, only from the point in the Act from where this assumption is drawn.

**Figure 3: Hierarchy of agencies regarding the establishment of SEZs and their function**



## 2.7 Making the SEZ operate

Once approval for setting up an SEZ is obtained, the developer has to get the SEZ going. First of all, notification of the SEZ is essential for this, after which approval for authorised operations could be sought. Later, separate units – the actual life-filling entities of the SEZ – can be applied for.

**Table 2: Procedure of SEZ notification and demarcation**

Step No.	Details	Remarks
1	Land acquisition process has to be completed by the developer	<ul style="list-style-type: none"> <li>Land should be vacant and contiguous with no encumbrances or public thoroughfare</li> <li>Land may be freehold or leasehold</li> <li>If leasehold, the period of lease has to be for a minimum of 20 years</li> </ul>
2	Submission of landholding details to the Central Government (sec. 7 SEZ Rules)	<ul style="list-style-type: none"> <li>The exact particulars of the land in question need to be submitted along with proof of legal ownership. A certificate from the state government is required to show that the land is unencumbered</li> <li>In case of any additional terms in the LoA, the acceptance of the same needs to be shown</li> </ul>

Step No.	Details	Remarks
3	Notification of the identified area as an SEZ (sec. 8 SEZ Rules)	<ul style="list-style-type: none"> <li>Central Government will issue notification identifying a specific area as an SEZ. This will be published in the <i>Official Gazette</i> and will contain all the details of the land which has been identified as an SEZ</li> </ul>
4	Central Government appoints the Development Commissioner and notifies the Approval Committee	<ul style="list-style-type: none"> <li>Has to be done within a period of six months from the date of establishment of the SEZ</li> </ul>
5	Work of the Development Commissioner	<ul style="list-style-type: none"> <li>The Development Commissioner demarcates the areas within the SEZ as processing and non-processing zones</li> </ul>

Having the Letter of Approval or the notified and demarcated SEZ area does not mean that operations in the SEZ can commence yet, though. In fact, two more approvals are required, as can be seen from Tables 3 and 4:

**Table 3: Procedure for a Grant of Approval for authorised operations in an SEZ**

Step No.	Details	Remarks
1	Submission to the BoA of the details of the operations proposed in the SEZ by the developer (sec. 9 SEZ Rules)	<ul style="list-style-type: none"> <li>Fiscal concessions only available on the basis of the authorised operations after the grant of approval</li> </ul>
2	Authorisation by the BoA (sec. 9 SEZ Rules)	<ul style="list-style-type: none"> <li>The BoA may authorise the developer to undertake any operations that the Central Government may authorise</li> </ul>
3	Application to the Approval Committee (sec. 10 and 12 SEZ Rules)	<ul style="list-style-type: none"> <li>Developer to make a list of the items/goods and services which will be required to carry on the authorised operations in the SEZ and to seek permission from the Approval Committee for the procurement of the same</li> <li>The Approval Committee will approve the import or procurement of the goods/services from the DTA for the authorised operations</li> </ul>
4	Steps to be taken thereafter by the developer (sec. 22 SEZ Rules)	<ul style="list-style-type: none"> <li>Developer undertakes the various steps required to commence authorised operations such as execution of a Bond and Legal Undertaking regarding adherence to SEZ laws</li> </ul>

**Table 4: Procedure for setting up a unit in an SEZ**

Step No.	Details	Remarks
1	Proposal for setting up a unit in an SEZ made to the Development Commissioner (sec. 17 para. 1 SEZ Rules)	<ul style="list-style-type: none"> <li>• The proposal has to be submitted to the Development Commissioner</li> <li>• Existing units from former EPZs, etc. shall be deemed to have been set up in accordance with the provisions of the SEZ Act and will not require any fresh approval</li> </ul>
2	The Development Commissioner forwards the proposal to the Approval Committee (sec. 17 para. 2 SEZ Rules)	<ul style="list-style-type: none"> <li>• On receipt of the proposal, the Development Commissioner shall submit the same to the Approval Committee for its approval</li> </ul>
3	The Development Commissioner forwards the proposal to the Board of Approval (sec. 17 para. 3 SEZ Rules)	<ul style="list-style-type: none"> <li>• In the following cases the Development Commissioner will have to forward the proposal to the BoA for approval: <ul style="list-style-type: none"> <li>- proposal for units for foreign collaborations and foreign direct investments in the SEZ for its development, operation and maintenance</li> <li>- proposal for a unit engaged in providing infrastructure facilities in an SEZ</li> <li>- proposal for granting a licence to certain industrial undertakings to be established as a whole or in part in an SEZ</li> </ul> </li> </ul>
4	Approval by the Approval Committee (sec. 18 SEZ Rules)	<ul style="list-style-type: none"> <li>• The Approval Committee may either approve the proposal with or without any modification subject to such terms and conditions as it may deem fit to impose, or reject the proposal</li> <li>• In case of modification or rejection, the person concerned must be given reasonable opportunity to be heard, after which the proposal will be modified or finally rejected</li> </ul>
5	Grant of Letter of Approval (sec. 19 SEZ paras. 1 to 3 Rules)	<ul style="list-style-type: none"> <li>• The Development Commissioner may, after approval of the proposal grant, send a Letter of Approval to the person concerned to set up a unit and undertake such operations. Every operation authorised this way shall be mentioned in the Letter of Approval</li> </ul>

6	Start of operations (sec. 19 SEZ para. 4 SEZ Rules)	<ul style="list-style-type: none"> <li>• The Letter of Approval will be valid for one year, within which time the unit must start the operations for which it has been granted approval</li> </ul>
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The aforementioned outlines give an overview of the salient features of an SEZ besides introducing the reader to approval and administrative procedures with regard to the setting up and functioning of an SEZ. Due to several controversies regarding these new kinds of industrial hubs, many rules (and the implementation thereof) are still in a state of flux. Some of the aspects shall be highlighted in the next chapter.

### 3 Special Economic Zones – zones of controversy

After the initial hiccups in March 2000, when Murasoli Maran announced the new policy regarding tax-free enclaves, the concept of an SEZ and its implementation seemed to sail in calm waters. But soon, with farmers experiencing dispossession of their land and political parties exploiting the plight of the farmers for their own political ends, the discussion became more heated, leading to a host of protests. At first, there were some court cases challenging the setting up of SEZs, especially the legitimacy of forceful land acquisition on grounds of “public purpose”. But later, the resistance became really “Indian” when people and parties took to the streets and politicians started fasting and lamenting the neo-liberal land grab and the Government not knowing how to appease the storm.

Land, especially agricultural land in India, is a very delicate subject and has been an emotive issue ever since the *zamindari* days. Land is the livelihood of millions of people. Not only the immediate owners of the land are affected, but also share-croppers or daily wage labourers who eke out their living through a scant, but reasonably reliable source of income. The interests of the developers wishing to set up an SEZ could not be more diametrically adverse. They need large tracts of contiguous land to establish export-orientated production zones, thereby causing the need to acquire land from those who make a living from it. Farmers first tried to safeguard their interests through litigation. In November 2006, farmers from the Jamnagar District in Gujarat moved the High Court of Gujarat and later even the Supreme Court to challenge the setting-up of a 10,000-acre (approx. 4,000-ha) SEZ by Reliance Infrastructure. They alleged that the acquisition of large tracts of agricultural land in the villages of the district not only violated the Land Acquisition Act of 1894, but was also in breach of the public interest. This led the Government to “consider” putting a ceiling on the maximum land area that can be acquired for multi-product zones and decide to “go slow” in approving SEZs. In this context, the

left-wing parties started demanding a cap on at least the IT SEZs<sup>10</sup> or even putting a final ceiling on the total number of SEZs to be permitted. Some small-scale protests against land acquisition in Maharashtra were put down by the police, which – according to some – “served to increase the frustration, anger and suspicion about the state machinery being the agent of the corporates (...). This can lead to militancy and worse”, was the dark forecast in an article in a left-leaning weekly,<sup>11</sup> concurring with the introductory remark made by the former Prime Minister of India, V. P. Singh.

And sure enough, the controversy led to severe clashes at Nandigram in West Bengal’s East Midnapore District south-west of Kolkata (former Calcutta). Not at first, as one might suspect, between angry farmers and state forces, but between members of a resistance movement under the banner of the newly formed Bhumi Uchhed Pratirodh Committee or BUPC (literally, Committee for the Resistance to Eviction from Land) and activists of the ruling Communist Party of India (Marxist) or CPI (M). At the heart of the scuffle lay the proposed Nandigram SEZ project, which was initiated by the West Bengal government to set up a chemical hub in a joint venture with the Salim Group from Indonesia. The Salim Group was founded by Sudono Salim, closely associated with Indonesian ex-President Suharto. The chemical hub would have required the acquisition of over 14,000 acres (57 km<sup>2</sup>) of land. The SEZ would have been spread over approximately 29 villages, thereby affecting tens of thousands of rural dwellers. As expected, the prospect of losing their land and consequently their livelihood made the predominantly agricultural populace sensitive and alert. All this happened, although no official notification of land acquisition was announced. The situation was rather shady in Nandigram, with rival political factions accusing each other of spreading rumours that local authorities were issuing notices about the acquisition of land. The administration denied there was any such move and that it was yet to identify the areas to be acquired. Many political agents started fishing in troubled waters and further adding fuel to the fire, leaving many CPI (M) workers on the run and some even dead – in fact, there was so much trouble that the CPI (M) had to organise relief camps in its stronghold to protect its members from the agitated crowd. Supporters of the BUPC were at the receiving end here. The BUPC managed to keep Nandigram under its control for some time. Naturally, the CPI (M)-led State Government of West Bengal could not ignore this challenge and directed the police to break the BUPC’s resistance at Nandigram; a

<sup>10</sup> Times of India, Farmers take RIL to court over SEZ land acquisition, 11<sup>th</sup> November 2006, p. 15; The Hitavada, Govt to go slow on IT SEZs, 9<sup>th</sup> November 2006, p. 13.

<sup>11</sup> S. G. Vombatkere, Special Economic Zones – Neo-Zamindari Zones?, in: MAINSTREAM, 9<sup>th</sup> December 2006: 9. In the same issue, there is an appeal with a demand for “a national moratorium on all acquisition and displacement till a national consensus is arrived at”. The appeal continues to demand “a national policy for overhauling the land acquisition, SEZ and related Acts and for providing an effective blueprint to protect the interests and concerns of all the affected persons”. It is inter alia signed by a former well-known Supreme Court judge, Justice V. R. Krishna Iyer, and many professors of eminence such as Rajni Kothari and other public persons (p. 5).

massive operation with at least 3,000 policemen was launched on 14<sup>th</sup> March 2007. A group of armed and trained CPI (M) cadres wore police uniforms and joined the forces. However, prior information about the impending action had leaked out to the BUPC, who amassed a crowd of roughly 2,000 villagers at the entry points into Nandigram, with women and children forming the front ranks. In the resulting mayhem, at least 14 people were killed and claims of large-scale sexual crimes were made afterwards.<sup>12</sup>

The aforementioned example shows the explosiveness of the issue regarding SEZs. These commercial hubs started with lots of premature praise and have now become a bone of contention which is readily exploited by political forces to the detriment of the peasants, who fear losing their means of livelihood. The situation is often aggravated by local or state politics. The situation in West Bengal has to be seen against the backdrop of an almost 30-year-long spell of Communist rule. The CPI (M) has been changing its stand on economic issues since about 1994, of late courting foreign direct investment and showing the world that Indian Communists are also capable of going global and capitalist. On the one hand, the CPI (M) under the leadership of its Chief Minister Buddhadeb Bhattacharya has lured TATA to Singur in West Bengal, where this global player wants to establish a car plant to produce the “one-lakh car” and also wants to pave the way for the Indonesian giant. This change in attitude is best summed up by a statement made by a leftist activist: “Buddhadeb’s capacity for rational thinking has been dimmed by the adulation he is receiving from the industrialists, Indian and foreign, western ambassadors, World Bank officials (...). When he came to power in 2006, he made it a point to say publicly that one of the first calls he received was from Ratan Tata.”<sup>13</sup> This may be one example of how changes in economic policies in the centre, i. e. in the central legislation, alter state politics. Nandigram may be the turning point for left-wing politics in West Bengal, blowing away the myth that the CPI (M) is pro-minority. On the other hand, at the centre, where the CPI (M) tolerates Manmohan Singh’s minority government, it tries to slow down any move it perceives as being capitalist. Mamta Banerjee, the supremo of the Trinamool Congress, a break-away faction of the Indian National Congress, uses every opportunity possible to derail public life and draw mileage from the controversies and clashes without really offering any solutions to the deadlock. Interestingly, earlier, it was a party leader of the CPI (M), Sitaram Yechury, who flayed the Central Government for not providing proper “national guidelines on agricultural land acquisition for industrialisation as the prevailing Land Acquisition Act was enacted in British India way back in 1894”. He further demanded that a new law should replace the colonial Land Acquisition Act, which ensures “that the owners of acquired land have not only consented but become stakeholders in future projects”. Compensation should not only cover the

<sup>12</sup> The Hitavada, Six killed over SEZ land acquisition in W Bengal, 8<sup>th</sup> January 2007, p. 1 and 5.

<sup>13</sup> Outlook, Nandigrammed, 19<sup>th</sup> February 2007, p. 20.

landowners, but equally all other sections who are dependent on agricultural land for their livelihood.<sup>14</sup> From the other side of the political spectrum, this idea has been taken up by Mukesh Ambani, one of “Shining India’s” business tycoons who is also an ardent SEZ developer. He is also of the opinion that stakeholders in land acquisition issues should be made future “shareholders” of some sort in the emerging SEZ. Of what sort, remains to be seen.

The conflict in Nandigram continued to simmer long after it had been decided that the state government would scrap its plans to establish the proposed SEZ at that site. As one professor from West Bengal put it, the outbursts occurred because it was rumoured that the land acquisition notice had not been removed from the notice-board.<sup>15</sup> If this is enough to spark off and fuel such tensions, then it does not augur well for all the hundreds of SEZs that are still to be set up.

Sensing the potential for further eruptions, the Central Government put all pending proposals to establish an SEZ on the back burner for more than two months. The SEZ Rules were amended in this period, although the changes made were more of a technical nature. Continuing public debate led the EGoM to hold a meeting at the beginning of April in which significant changes were finalised, wittingly below the level of the change of the SEZ Act or even the SEZ Rules. It was simply directed that henceforth there would be a ceiling of 5,000 hectares on every SEZ area, irrespective of whether it had already been approved or not. Tellingly, the leftist parties had asked for a ceiling of 2,000 hectares for multi-product SEZs, claiming that this would prevent them from turning into “speculative real estate operations”. However, the Central Government leaves it to the states to decide whether they want to lower the cap or not. So, hypothetically, if the left front Kerala Government so wishes, it could even put a cap of 1,001 hectares on multi-product SEZs (the minimum size is 1,000 hectares). The Central Government has also requested the state governments to refrain from acquiring land themselves and to leave this process to private dealings between the developer and the landowner. The capping puts those developers who had already planned SEZs larger than 5,000 hectares in size prior to the EGoM decree in a fix. DLF, a large-scale developer, had planned an 8,000-hectare multi-product SEZ in Gurgaon near Delhi, for example. After the setback due to the EGoM decision, DLF went back to the drawing board and now has plans to split its large SEZ into two parts, one with a maximum size of 5,000 hectares and the other with the excess amount of 3,000 hectares. This is certainly an ingenious move, which leaves the ministers dazzled who have not as yet specified whether promoters are allowed to build two SEZs in a contiguous area.<sup>16</sup> In the face of pressure from

<sup>14</sup> The Hitavada, CPI (M) flays Govt, seeks changes in SEZ law, rules, 24<sup>th</sup> December 2006, p. 13.

<sup>15</sup> This section draws information and political assessments from a lecture entitled “What is happening to West Bengal?” by Prof. Dr. Harihar Bhattacharyya, Dean of the University of Burdwan, West Bengal, held on 8<sup>th</sup> May 2007 at the South Asia Institute in Heidelberg.

<sup>16</sup> Indian Express, DLF keen to split Haryana SEZ in face of new laws, dated 7<sup>th</sup> April 2007 as last seen on 12<sup>th</sup> July 2007 on <http://www.indianexpress.com/printerFriendly/27701.html>.

the left parties, from the public and the media, the EGoM also announced that the Ministry of Rural Development had been requested to reformulate a comprehensive land acquisition act to address all relevant issues and that a comprehensive Resettlement and Rehabilitation Policy would be developed, ensuring that at least one person from each displaced family would be able to earn their livelihood from the project.<sup>17</sup> What the EGoM failed to mention in its press release was that a ‘National Policy on Resettlement and Rehabilitation for Project-Affected Families’ had already appeared in 2003 (i.e. before the SEZ Act), but was then swiftly shelved. Pre-empting calculable dissatisfaction over land acquisition, the aforementioned policy should have pre-dated SEZ policy and law, not followed it, notwithstanding problems of reasonably compensating those who do not possess any land titles. Just how incoherent the policy-makers are is manifested by another news snippet, which quotes the Minister of Commerce, Kamal Nath, as saying: “For the moment, there is a ceiling on the size of zones. Should an SEZ proposal come up in the future that looks at an area larger than the cap, the government will be willing to look at it.”<sup>18</sup> There are also strong reservations about the Central Government’s policy to keep out of land acquisition. Viewed objectively, leaving land acquisition to free market forces may harm the farmer sometimes, while at other times it may stand in the way of further industrialisation, the necessity of which is obvious to most people. Promoters/developers may play off different groups of farmers against each other and as a result may be able to buy the land at a fraction of the price in the end. In other instances, certain farmers who may be the last people to sell their plot of land in an otherwise contiguous area would assume tremendous “hold-up” power, thereby making land unreasonably expensive. Also, it is not always realistic to confine the development of SEZs to wasteland or uncultivated land. At any rate, one also has to bear in mind that much less than one per cent of all agricultural land is earmarked for industrial use. Nevertheless, the key question remains as to how to conduct the promotion of SEZs as part of a wider shift in economic paradigms while ensuring that the rural population does not remain disaffected and gets its share of the benefits of industrialisation. One answer lies in the profound overhaul of the archaic Land Acquisition Act of 1894, designed by a colonial government that put very little emphasis on the welfare of the average person. In this respect, the compensation process – its transparency, accuracy and efficiency – plays a crucial role together with the credibility of the executing (state) agencies.<sup>19</sup>

<sup>17</sup> Press release issued by the Public Information Bureau (PIB) of the Government of India dated 5<sup>th</sup> April 2007. Last read on 12<sup>th</sup> July 2007 at [http://pib.nic.in/release/rel\\_print\\_page1.asp?relid=26679](http://pib.nic.in/release/rel_print_page1.asp?relid=26679).

<sup>18</sup> MSN India, Cap on SEZ land not inflexible: Nath, dated 19<sup>th</sup> April 2007, last viewed on 12<sup>th</sup> July 2007 at [http://content1.msn.co.in/News/Business/BusinessBS\\_190407\\_1128.htm](http://content1.msn.co.in/News/Business/BusinessBS_190407_1128.htm).

<sup>19</sup> For further ideas, see: Commentary, Beyond Nandigram: Industrialisation in West Bengal, in: EPW, 28<sup>th</sup> April 2007, p. 1487-9.

With the purported support of the majority of the state governments, the Central Government still manages to tread the SEZ path somehow (what with the campaign to generate employment as well). But it is also aware of the fact that no peaceful and sustainable settlement of the issue will be arrived at without having a proper rehabilitation policy, which is indispensable as any estimate envisages that hundreds of thousands of people who are mostly peasants would be affected by land acquisition for SEZs. And the SEZ lobby – be it from the state or from the private sector – has to ask itself how many more Nandigrams the Indian state is able to afford.

The land controversy outlined above is not the only one hovering around the SEZ by any means. The SEZ policy has led to inter-ministry friction occurring, with the Finance Ministry bemoaning the prospect that the promotion of SEZs in the manner it is presently being conducted by the Commerce and Industries Ministry would cause a loss in revenue to the tune of over Rs. 160,000 crores by 2010 (an estimated €30 billion or US\$36 billion). The Commerce Ministry tautly replied that the Finance Ministry's projections were merely based on "paper calculation". The Commerce Ministry actually expects an investment sum of Rs. 100,000 crores by the end of 2007 (roughly €18 billion or US\$22.7 billion), which, in turn, would result in a revenue gain of Rs. 44,000 crores (€800 million or US\$1 billion) besides creating hundreds of thousands of new jobs.<sup>20</sup> Some subjects are still on the back burner, but surface here and there, e.g. in questions about the relationship between the Central Government and the states or about the environmental impact SEZs are likely to have. No one knows whether India will be as successful as the Chinese endeavour with SEZs is regarded as being or how the social unrest created will eventually be tackled.

#### **4 Some final tentative remarks**

This introduction has explained both the reason why and the way in which Special Economic Zones have been introduced in India. The policy-makers are deliberately attempting to leave the path their political forefathers trod in occupying the "commanding heights". But in view of stiff opposition from the peasants affected by these projects, from political agents fishing in troubled waters and from the business world, the erstwhile liberal SEZ policy is in danger of becoming more and more regulated. It is argued that this need not have been the case to such an extent had the ministers concerned made up their minds to formulate a comprehensive displacement and rehabilitation policy preceding the (often forceful) land acquisitions to establish SEZs. The Indian legal system, which by and large is viewed as stable and reliable, has proven to be volatile in this case, with the EGoM clipping the SEZ Act and Rules on various accounts. As has been shown, investments planned or already executed have to be reconsidered thanks to the 5,000-hectare cap. And farmers are

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<sup>20</sup> Frontline, Conflict Zones, 20th October 2006, p. 4.

in danger of becoming bargaining armies in the hands of political parties all lining up to take up their cause as long as the parties are not in a responsible position; instead, the latter simply want to act as spoilsports, knocking the Central Government. Nevertheless, one thing does seem clear: “SEZs have come to stay, but they need to operate in a manner in which the concerns that have been expressed can be dealt with.”<sup>21</sup>

One way to pacify these concerns would be to amend or thoroughly reform the Land Acquisition Act of 1894 and install a transparent rehabilitation law. It will have to be seen whether SEZs have come to stay or whether there will be a political stalemate on the SEZ issue. Seen as expressions of a functional democracy, this need not be perceived as a weakness of the Indian system.

#### **Annex: fact sheet on SEZs in India (as of 21<sup>st</sup> June 2007)**

SEZ Act 2005	✓ Passed by Parliament in May 2005 ✓ Received Presidential Assent on 23 <sup>rd</sup> June 2005 ✓ Came into effect on 10 <sup>th</sup> February 2006
SEZ Rules 2006	✓ Notified by the Central Government on 10 <sup>th</sup> February 2006 ✓ Amended twice in August 2006 and March 2007
SEZs formally approved:	303
SEZs formally notified:	127
SEZs approved in principle:	161
Land requirement:	For SEZs formally approved: approx. 415 km <sup>2</sup> For SEZs approved in principle: approx. <u>1,430 km<sup>2</sup></u> <u>1,845 km<sup>2</sup></u> <i>For reference:</i> total land in India (excluding the Ocean rim): 2,973,190 km <sup>2</sup> total agricultural land in India: 1,620,388 km <sup>2</sup> Chinese SEZ: Shenzhen 327 km <sup>2</sup> Hainan 34,000 km <sup>2</sup> Total area proposed for SEZs (approved and approved in principle) not more than 0.062 per cent of the total land area and not more than 0.11 per cent of the total agricultural land in India.
Investment made in 127 notified SEZs:	€6.39 billion (US\$7.99 billion) (exchange rates for EUR and US\$ of Rs. 55 and Rs. 44)
Employment created in 127 notified SEZs:	32,578 persons
Expected investment and employment from SEZs (by December 2009):	127 notified SEZs: investment: €26.99 billion (US\$ 33.74 billion) employment: 1.55 million additional jobs If 303 SEZs become operational: investment: €4.54 billion (US\$ 68.18 billion) employment: 4 million additional jobs

<sup>21</sup> Frontline, ibid.

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Exports in the financial year 2006-2007:	€6.32 billion (US\$7.91 billion), €1.69 billion (US\$2.11 billion) of which account for new-generation SEZs. This is a growth of 52 per cent over the previous financial year, 2005-2006.
Exports projected by all 146 SEZs (19 old and 127 new ones) in the financial year 2007-2008:	€12.24 billion (US\$15.30 billion)

Source: Ministry of Commerce and Industry, Department of Commerce, Government of India as seen on [www.sezindia.nic.in](http://www.sezindia.nic.in) (last viewed on 4.7.2007).

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