Chapter 1
Introduction
CHAPTER  I

INTRODUCTION

Special Economic Zones world over have been used as a trade facilitation and development instrument. The Indian story of SEZs also rests on similar objectives amongst others. There have been a number of schemes in the past aimed at ushering in economic growth through increased exports like hundred percent EOU, DEPB, DEEC, EPCG, and DFIA etc. In all the above schemes the primary objective has been generation of as much foreign currency as possible.

With the liberalization policies of Government of India started in the early 90s the Balance of Payments position improved. The Government started exploring various measures towards an integrated approach to usher in economic growth through foreign trade, where the primary objective is not maximization of exports alone but also various other factors such as generation of additional economic activity, promotion of export of goods and services, promotion of investment from domestic and foreign sources, creation of employment opportunities, development of infrastructure facilities, technology transfer, creation of entrepreneurial talent which are sine-qua-non for economic growth. Hence the genesis of the concept of SEZ as a tool to achieve these objectives.

SEZs symbolized the changed government perspective that the export promotion schemes should no more be mere means of garnering foreign currency but also serve as growth engines. They were to serve as growth models integrated into the overall economic planning of the country. The vision of the economists and administrators in operationalising the SEZs, appears to have been realized as seen from the performance of the SEZs during the last six years.
Table 1.1
Performance of SEZs for the period 2005-06 to 2011-12

<table>
<thead>
<tr>
<th>Category</th>
<th>2005-06</th>
<th>2011-12</th>
<th>CAGR %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports (Rupees in crores)</td>
<td>22839</td>
<td>364478</td>
<td>58.67</td>
</tr>
<tr>
<td>Investment (Rupees in crores)</td>
<td>5881</td>
<td>277259</td>
<td>90.06</td>
</tr>
<tr>
<td>Employment</td>
<td>64870</td>
<td>201875</td>
<td>20.82</td>
</tr>
</tbody>
</table>

(Source: Engines for Economic Growth. Booklet published by Export Promotion Council for EOU and SEZs)

From Table No.1.1, it is observed that exports increased from Rs. 22839 crores in 2005-06 to Rs.364478 crores in 2011-12 showing an impressive growth rate of 58.67% (CAGR). Investment showed an increase from Rs.5881 crores to Rs.277259 crores during the same period indicating a phenomenal growth rate of 90.06% (CAGR). The growth ignited by the SEZs in the above two sectors of the economy has led to tripling of employment from 64870 to 201875 recording 20.82% (CAGR) growth rate thereby justifying the establishment of SEZs.
1.1 REVIEW OF LITERATURE:

At this juncture it is thought pertinent to have an insight into research studies on SEZs both at national and international level. Dorasati Madani (1999)\(^1\) concluded that SEZs are tools to experiment with economic changes; Helena Johnson and Lars Nilsson (1997) opined that EPZs have a catalytic effect on the economy of the country, as the foreign firms operating from SEZs enlighten the local firms on the techniques of production. Similar views have also been expressed by Xie Wei (2000), Kankesu Jayantha Kumaran (2002), Nicolas Papadopoulos and Shavin Malhotra (2007), William G.Tyler et al (2009). Haywood (2000)\(^2\) strongly supported the zone-concept as “a dynamic, investment-intensive, management-driven, enabling and integrated economic development tool.”

Dorasati Madani (1999) is of the view that EPZs are providers of foreign currency. The findings of Nicolas Papadopoulos and Shavin Malhotra (2007)\(^3\) concurred with those of Dorasati Madani; Kankesu Jayantha Kumaran (2002)\(^4\), after studying the operation of SEZs in Sri Lanka, Indonesia, Malaysia etc., concludes that SEZs benefitted the host country in terms of achievement of objectives of employment generation. Dorasati Madani (1999), Nicolas Papadopoulos and Shavin Malhotra (2007), Vijaya Ramachandran and Rachel Cleetus (1999)\(^5\) also confirmed that SEZ/EPZs contributed to generation of additional employment; Aradhana Aggarwal (2007)\(^6\) emphasized that SEZs create indirect employment in more ways than one. Nadeem M. Firoz and H. Amy

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\(^3\) Papadopoulus, Nicholas and ShavinMalhotra (2007): “The role of export processing zones in development and international marketing strategy: review of key issues and suggestions for research”. Sprott letters, Sprott School of Business, Ottawa, Canada.

\(^4\) Jayanthakumaran, Kankesu (2002);”An overview of export processing zones: selected Asian countries,” wp 02-03, Department of Economics, University of Wollongong, New South Wales, Australia.

\(^5\) Ramachandran, Vijaya and Rachel Cleetus (1999);”Export processing zones: Lessons for Tamil Nadu”. Research study conducted by Centre for International Development (CID), Harvard University, USA for Government of Tamil Nadu.

Murray (2003)\textsuperscript{7}, while furnishing the rationale behind the evolution of SEZs in China, observed that the SEZ policy resulted in China becoming the largest FDI recipient in the world; Dorasati Madani (1999), Nicolas Papadopoulos and Shavin Malhotra (2007), Vijaya Ramachandran and Rachel Cleetus (1999), also concluded that SEZs/EPZs are successful in attracting FDI. Madani (1999)\textsuperscript{8} however argued that FDI flowing into the SEZ meant import of capital but withdrawal of labour from domestic market distorted production away from its factor based competitive efficiency.

Jean-Pierre Cling and Gaelle Letilly (2001)\textsuperscript{9} established that EPZs have benefitted emerging countries like Indonesia, Malaysia, and Mexico through increased exports; Nicolas Papadopoulos and Shavin Malhotra (2007), Vijaya Ramachandran and Rachel Cleetus (1999), Maria Peregrina Makabenta (2002)\textsuperscript{10} also concurred that SEZs/EPZs help increase exports. Maria Peregrina Makabenta (2002), after analyzing the extent of SEZ effects on manufacturing FDI in Philippines, concluded that SEZs in Philippines led to a substantial increase in investments and exports with creation of supportive infrastructure; Aradhana Aggarwal (2006)\textsuperscript{11} observed that the benefits offered to SEZs provide a conducive business environment to attract both local and foreign investments; Nicolas Papadopoulos and Shavin Malhotra (2007), Maria Peregrina Makabenta (2002) also agreed that SEZs/EPZs contribute to creation of efficient infrastructure and expansion of support services.

Michael Engman et al (2007)\textsuperscript{12} observe that EPZs have proliferated as tools for achieving different economic objectives with reference to case studies in India, Russia and China. As per their study, EPZ policy is the second best economic tool. Nicolas Papadopoulos and Shavin Malhotra (2007) list different benefits the host countries derive

\textsuperscript{8} Ibid. p85
\textsuperscript{10} Makabenta, Maria Peregrina (2002): FDI location and Special Economic Zones in the Phillipines.” RURDS.14(1).
due to EPZs that include creation of local supply chains, regional development, and expansion of support services amongst others. Albert G. Schweinberger (2003)\textsuperscript{13} identified the benefits that would flow from SEZs in developed and transition economies and concluded that SEZs, inter alia, help increase the value of output of the country at world market prices.

Karima Omar and William A. Stoever (2008)\textsuperscript{14} outline the life cycle theories of EPZs to show how EPZs create an environment which fosters backward linkages in the domestic environment and enable a competitive environment for the foreign producers while William G. Tyler and Ana Carolina A. Negrete (2009)\textsuperscript{15} conclude that EPZs perform the role of catalysts which stimulate the local firms to export by demonstrating ways and means of producing, partnering and marketing and distributing products in overseas market and therefore accelerate the rate of technological progress in a developing host country. Aradhana Aggarwal (2007) observes that SEZs not only generate direct employment through their units, they also create indirect employment in more ways than one and are also expected to contribute substantially to women empowerment; Yerram Raju and Ramakrishna (2007)\textsuperscript{16} observe that SEZs have led to significant increase in the income levels of many Asian countries namely, Hong Kong, Taiwan, Malaysia, Indonesia and South Korea. However it is also observed that in certain countries like Mauritius, Costa Rica, Sri Lanka, these Zones have had a significant impact in the promotion of manufactured exports.

Hongyi Harry Lai (2006)\textsuperscript{17} analyses how China invented and utilized SEZs to open up to outside world and identifies zone location, leadership, institutional arrangements and local initiative as favorable factors that led to SEZ success; Wanda

\begin{thebibliography}{99}
\bibitem{Omar} Omar, Karima and Stoever, William A. (2008): The role of technology and human capital in the EPZ life-cycle” Transnational Corporations.17(1).
\bibitem{Tyler} Tyler, William. G and Ana Carolina A. Negrete (2009); Economic growth and export processing zones and empirical analysis of policies to cope with Dutch disease.” Prepared for the LASA 2009 Congress.
\end{thebibliography}
Guo and Yueqiu Feng (2007) concluded that the success of Shenzhen SEZ is the result of special policy framework provided by the Central Government of China to attract FDI, heavy migrant population present in Shenzhen, well established infrastructure and locational advantage of Shenzhen being a coastal city bordering Hong Kong. Peter L. Watson (2001) emphasizes the importance of socio political and economic management skills for an EPZ establishment and shows how their absence led to the negligible success in many Export Zones in Africa. Labour Resource and Research Institute, LaRRI (2000) concludes that there is a limited evidence of technology transfer and linkages as important by products of EPZs in host countries.

Rajiv Kumar (1989) is of the view that Indian zones have been used predominantly by domestic entrepreneurs, leading to the inference that foreign capital and technology have contributed only marginally to the growth of Indian zones. Export Import (EXIM) Bank of India (2000) analyses the EPZ performance of countries across the world reveals poor performance of Indian EPZs in contrast to some successful ones. Venugopal (2005) argues that contract workers in Cochin SEZ are deprived of the benefits and privileges enjoyed by regular employees; Rama Krishna Ranjan (2006) observes that, despite special treatment, performance of SEZs in India remained unsatisfactory. However these observations are made when the SEZ scheme was at the formative stage as the SEZ Act had come into force only in 2005 and its Rules in 2006.

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21 Kumar Rajiv (1989):” India’s Export Processing Zones”. A research study conducted on behalf of Indian Council for Research on International Economic Relations (ICRIER), New Delhi, Oxford University Press, Oxford.
22 Exim Bank (2000):” Export Processing Zones in select countries: Critical success factors.” Occasional papers of Exim Bank, Mumbai, India. (The paper was released at the of the Hon’ble Ex-Minister of Commerce & Industry of India at the Board of Trade meeting, New Delhi. March 25, 2000.
RBI Staff Studies SS(DEAP):4/2009\textsuperscript{25} gives an optimistic picture and it observes “The revenue losses due to excessive fiscal concessions to the SEZs could be sizeable but at the same time the SEZs would generate more production and exports and thereby more revenue accruals, which would compensate the revenue losses incurred during the course of SEZ development”.

1.2 NEED FOR THE STUDY:

Given the crucial and significant position of the SEZs in national economy as envisaged above, it is the need of the hour to ensure that SEZs do not lose the impetus and momentum and become as vibrant as possible. While it is important to continuously evaluate the efficacy of SEZs in achieving exports, investment and employment objectives, the review of literature reveals the gap that there is a need to know the perceptions and expectations of the investors.

Since SEZ Act was passed in the year 2005 followed by the Rules in 2006, it is one of the nascent Acts that necessitated study vis-a-vis its objectives. The new SEZ regime has undergone eight years of implementation; therefore a study to gain insights into its workings may help in policy changes and directions. There are certain crucial aspects of the scheme like the single window scheme, the success of which will set it apart from the rest of the schemes and its functioning needs a study. At this juncture it is opportune to assess the impact of SEZs in Visakhapatnam regarding exports, investment and employment.

Studies have mostly concentrated on the overall impact of the SEZs. The investor despite being the major stakeholder has not been the focal point of the studies so far. The investor is in a better position to appreciate the efficacy of policy, legal framework, procedures of SEZ Scheme as they actually experience their effect while carrying out their authorized operations. This experience constitutes a vital feedback for the policy makers and administrators to identify the grey areas and impediments if any coming in the way of effective functioning of SEZs and thus to initiate pragmatic remedial measures.

and to make their functioning effective and purposeful. Thus the experiences of the investor of an SEZ will help in identifying critical factors in the scheme. These insights may help in identifying gaps if any and may also point to improvements. Hence this study also aims to understand the policy from an investor’s perspective.

To start with it is imperative that we map the basic profile of investors, followed by their view on attractiveness of the scheme, ease in establishment of units, different factors of SEZs influencing their production, macro environmental factors, internal environment in the SEZs their perceptions on SEZ governance, view on SEZ Rules and regulations, export facilitations and their contribution to the local economy. The views of the investors will be examined with special reference to the grey areas in the legal and administrative framework, hurdles, if any, that affect the momentum of the SEZs. The study will further seek to understand issues relating to coordination among various agencies involved in implementation and monitoring of SEZ scheme, infrastructural bottle-necks, role of State Governments, expectations of the investors and other measures that need to be initiated to render the SEZ framework as a viable policy instrument.

The investor as the key stakeholder, need also to be heard while studying the SEZ framework as the key objectives of the policy can be achieved only by attracting the investor. Visakhapatnam sets itself up as an ideal centre for study on the subject as it has a mix of all types of SEZs including an erstwhile EPZ, multi-product SEZ, sector-specific SEZs and IT SEZs.
1.3 SCOPE OF THE STUDY:

SEZ as a policy intervention is a field with wide possibilities. The impact on economy, socio-technological aspects, success as a policy tool, comparative analysis (global & local), sectoral comparisons, testing of theoretical postulates regarding markets, entrepreneurs, private-public debates are some of the fields open for study. More specifically, the legal and administrative frame works of SEZ schemes in various countries, while incorporating general provisions universally available, may contain certain unique and positive provisions. These provisions need to be studied in detail so as to assess their suitability to Indian context. For example one of the important aspects of SEZ policy of Poland is that the free trade exemptions or the incentives were based on the investment, its quantum and the number of local people employed. It is a positive provision as it provides for performance linked incentive. It needs to be examined whether such a provision is workable in the Indian context; if so, whether it can be made applicable universally or to specific sectors and areas.

Another area that needs further study is the perspective of foreign investors. As the foreign investors are the only source of FDI and attending technology transfer, their concerns need to be addressed to attract them to invest in SEZs in India. Factors like fiscal incentives, business environment and stable policy etc., would be top on the agenda of a foreign investor before embarking upon setting up of SEZs in India.

Other areas that need to be broadly studied are service sector, single window mechanism and shifting of investment. More than 50% of GDP comes from service sector. Therefore, further studies are needed to identify the specific problems of service sector. Consequential modifications to SEZ scheme to meet the specific requirements of service sector SEZs need to be suggested. Single Window Scheme is the back bone of the SEZ policy in India. A detailed study needs to be undertaken to identify the gaps and suggest changes in the single window scheme enshrined in SEZ policy. Need for such a study is more pronounced to attract new entrepreneurs into the SEZ arena. At this juncture it may also be pertinent to know whether SEZ scheme is attracting substantial virgin investment or only facilitating shifting of investment from DTA to SEZ, if so, the sectors in which the shifting is more profound. The question of extension of additional
incentives to the new entrepreneur venturing into SEZ arena also needs to be considered in detail.

Since the subject per se is vast, this study has however limited itself to the growth of SEZs in Visakhapatnam District and map the investor outlook and experiences since Visakhapatnam has been the birth place for SEZs in Andhra Pradesh which has the maximum approved SEZs in the country. It is a Tier II city with presence of multi-product, sector specific and IT SEZs. It therefore forms a fertile ground for this study.

1.4 OBJECTIVES OF THE STUDY:

Based on the scope and need, for the purpose of this study the following objectives have been identified to

1. review the evolution and growth of SEZs in India and abroad.
2. study the growth of SEZs in Visakhapatnam District.
3. prepare a profile of investors in the SEZs of Visakhapatnam District.
4. map the entrepreneur outlook and experiences on SEZs.
5. review the SEZ policies and suggest need-based changes, if any.

For the objectives 2 and 4 above, the following hypothesis will be used to test and gain insights:

(i) SEZs in Visakhapatnam did not improve the employment opportunities.
(ii) There was little growth of investment in SEZs of Visakhapatnam.
(iii) Export objectives were not achieved by SEZs in Visakhapatnam.
(iv) The investors of Visakhapatnam have not found the single window system to be effective.
(v) The investors do not have a positive opinion about the different interventions of the SEZ framework.
1.5 RESEARCH METHODOLOGY:

The methodology adopted for the present study involves collection of data from both primary and secondary sources. For primary data a comprehensive questionnaire was administered across the SEZ units in Visakhapatnam. For this a questionnaire (shown at Appendix-I) was administered to the entire populace of 191 units in operation. Out of this only 75 responded. A second questionnaire (shown at Appendix-II) was developed to map the outlook and experiences of the investor after conducting a pilot study. This questionnaire was administered to all the 75 investors who responded earlier. Of these, a total of 64 responses were received and this formed the basis for this study.

The secondary data relating to investment, employment generated, imports and exports, exemptions availed etc., collected from the internal reports and returns of the VSEZ, official website of the Department of Commerce (GoI) and also data published by the agencies dealing with SEZs like Export Promotion Council for EOUs and SEZs, WEPZA etc.

The data collected has been tabulated and analyzed with the help of relevant statistical tools like regression analysis, graphs, weighted averages and other diagrammatic representations.

1.6 LIMITATIONS:

For the purpose of this study only operational SEZs in Visakhapatnam District have been identified since a few SEZs have neither been notified nor operationalised. The first questionnaire embarked on profiling the investors and it was sent through mail followed by visits to the units. All the responses were not received owing to the investors pre-occupation and their other priorities. Though IT sector has been the dominant sector in India in general and Andhra Pradesh in particular, presence of only two IT SEZs housing a limited number of units in Visakhapatnam may not convey comprehensive perceptions of IT investors.