

What went wrong with India's SEZs?: Economics, Politics or Bureaucracy

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Why SEZs?

- **Economic approaches (Economic returns)**
 - Orthodox Approach
 - Dynamic orthodox approach
 - Heterodox Approach
 - New International Division of Labour (NIDL)
 - New Economic Geography (NEG)
- **Political economy approaches (Political returns)**
 - Public Choice theory: Interest group theory and rent seeking
 - Foreign Policy and the state: Soft power: Border and cross border zones and country specific zone; Qualifying zones of Egypt and Jordan);
 - SEZs to take advantage of preferential treatments.

Success factors

1. Economic factors

- Orthodox approach: low labour costs, tax incentives in import substituting regime (Macro vs micro I climate, international factors)
- Dynamic orthodox: Testing lab for reforms (Macro vs micro I climate)
- Heterodox: good investment climate within zones (Macro I, international)
- NIDL: Comparative and competitive advantages and low export costs (Micro and Meso investment climate)
- NEG: Agglomeration economies (micro and meso investment climate, strategy and vision)

2. Political factors

- Short term political returns
- Development state vs inclusive development state:
- Political will, vision and strategy

3. Bureaucratic factors: Policy designs & Implementation

- Poor policy designs
- Legal apparatus
- Adequate resources
- Understanding of SEZs
- Poor SEZ designs
- Lack of understanding of the implementation conditions: macro, meso and micro
- Approach towards SEZ (trust)

Failure of SEZs

- Failure is contextual.
- Failures may be for different reasons under different contexts across countries and within the same country across different phases
- Important to analyse the performance through different lenses.

SEZs in India: Three broad phases

- 1965-2000: The EPZ regime
- 2000-2005: Transition to SEZ regime
- 2005 onwards: The SEZ Regime

Phase 1: EPZ programme was introduced as part of import substituting regime....

- India: the first Asian country to have an EPZ in 1965. Three phases
- **1965-1984: Initial phase**
 - Highly regulatory regime, poor incentive package, Poor infrastructure
- **1985-1990 : expansionary phase**
 - 5 new EPZs were set up at Noida, Madras, Cochin, Falta, Vizag
 - EOUs
- **1991-2000: Consolidating phase**
 - Devolution of powers to zone administration, sectoral coverage was expanded, private sector EPZs, only one zone at Surat came up.

Phase I: Performance evaluation of EPZs

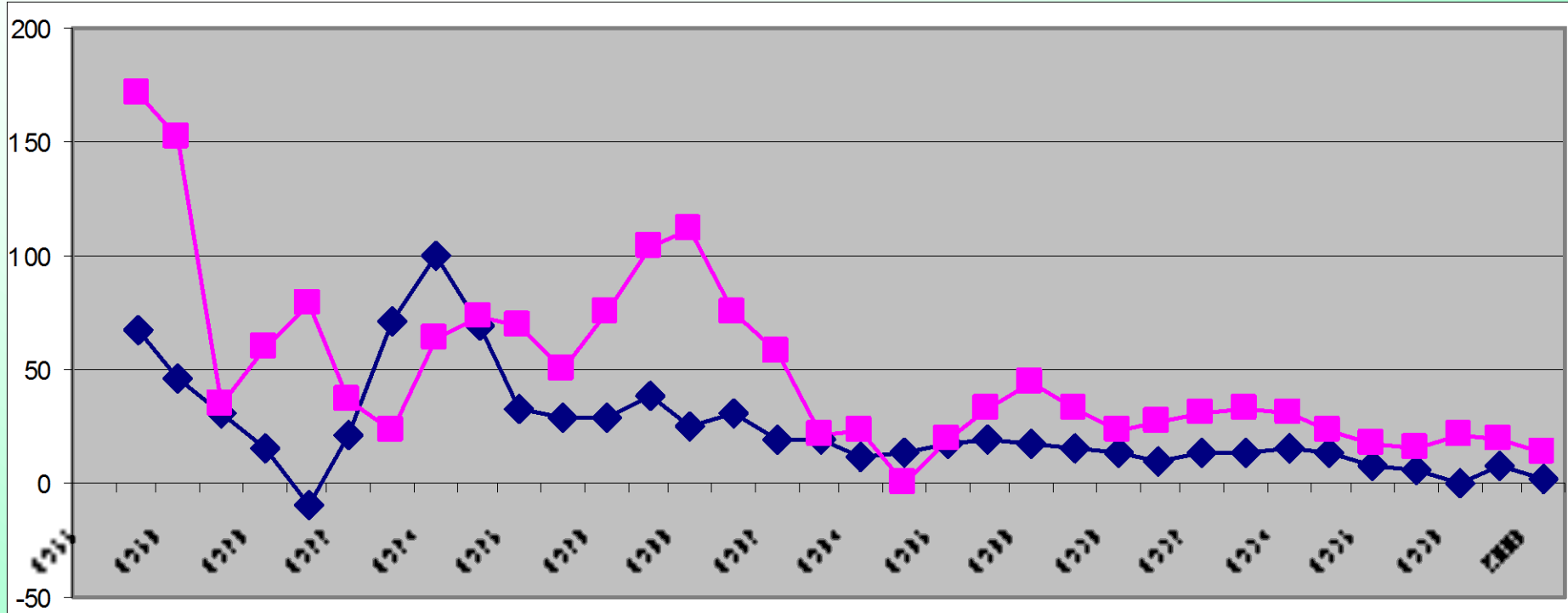


**National
Contribution**
to exports,
employment

Regional development
Contribution to employment,
Income generation
Ancilliary industrial activities
Most notable : SEEPZ, CSEZ,
Noida

At the sector level “ Selected cases of success at the industry level : Gems and Jewellery, Electronics, SW, rubber gloves.
2. Development of Local entrepreneurship

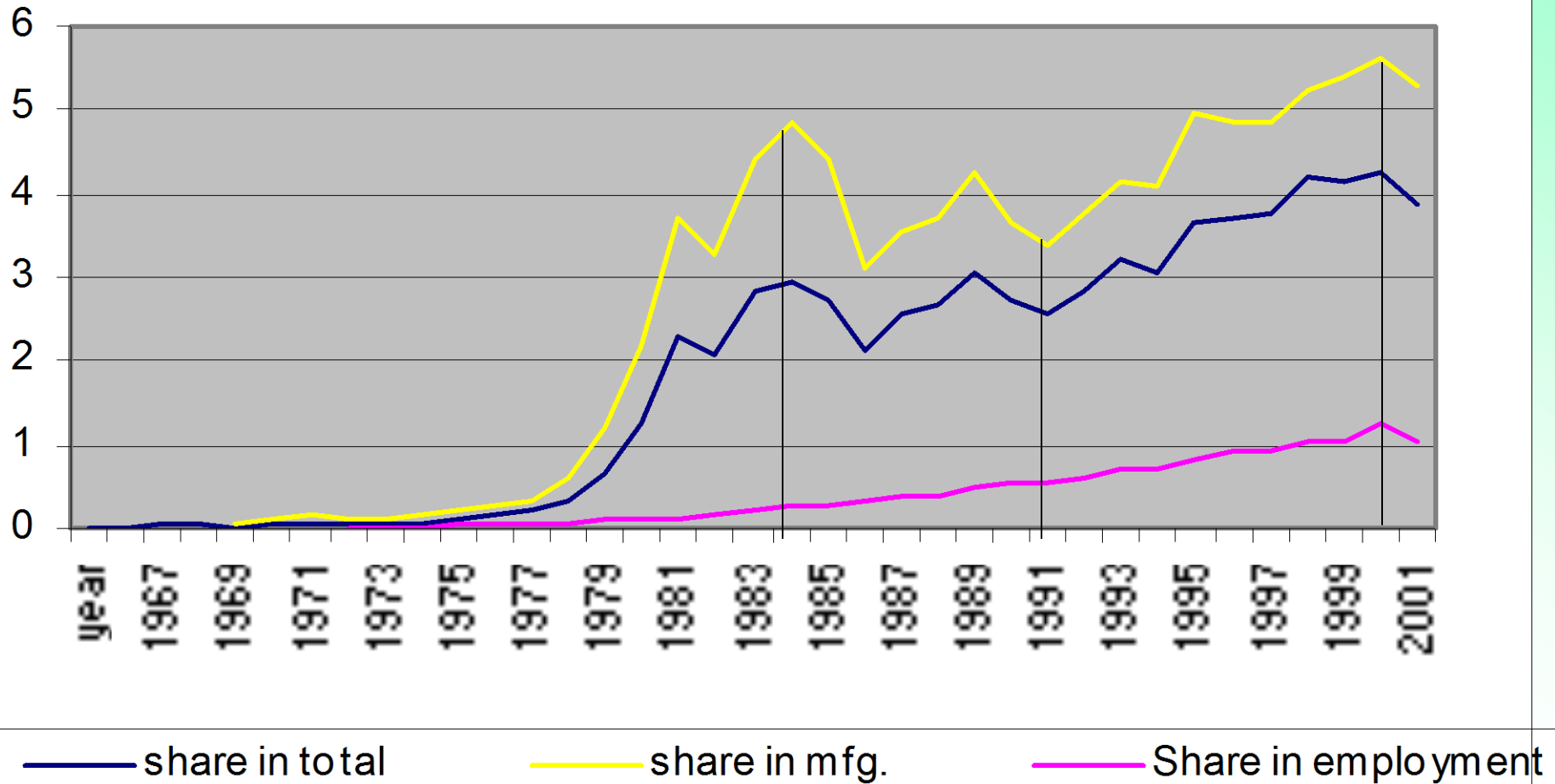
Phase I National level performance: Employment and export growth rates across seven zones in India



—◆— Mvepmgr

—■— MVEXPGR

Share in total and manufactured exports at the national level: Phase I



Why could EPZs not make a substantial impact at the national and regional levels in Phase I: Was it good economics?

- India in the initial stages of growth with unemployment and low incomes
- Development strategy : A three pillared strategy
 - heavy industries with public sector assigned commanding heights (contrary to comparative advantage theory)
 - planned economy
 - Import substitution
 - Development of industrial estates
- **This means**
 - Issue of unemployment
 - Lack of industrial capacity
 - Anti export bias and foreign exchange issues
- Justification of SEZs from the perspective of all theoretical approaches: EPZs could be testing lab for market driven policies:
- **Was it a missed opportunity?**

Was it politics or bureaucracy?

Political factors ?

- Inclusive development state and democratic institutions
- lack of vision and strategy- Not seen as a major tool of industrialisation

But bureaucratic failures : major bottlenecks

- Absence of legal apparatus
- Over cautious approach
- Spilling of outside economic environment into zones
- Lack of understanding
- Weak micro economic climate
- Poor meso-climatic factors
- Improvement in macro environment but relative advantages of EPZs did not improve.

- **EPZ of the first phase: Essentially, a bureaucratic failure.**

The Transition Phase : Phase II

- Private SEZs permitted.
- The SEZ package was enhanced
- No major changes in the political or bureaucratic set up

The SEZ regime phase III: 2005 onwards

- The SEZ act 2005 came into force in September 2005 to promote the export zones. On 10th Feb 2006, SEZ Rules also were enforced to promote SEZs in the economy.
- SEZs comprise of FTZs, EPZs, SEZs, Enterprise specific, and highly specialised zones, hybrid zones, country specific zones.
- First major effort to
 - use SEZs for large scale industrialisation in India.
 - To leverage capabilities of the private sector to drive industrialisation in the country
- Attractive incentives for private SEZ developers
- Supportive bureaucracy.

The Rise of SEZs: Unprecedented expansion

Period	Number of zones set up	Ownership	Area (in hectare)
1995-2000	7	Central government...7	894.4
2000-2006	12	State government----5 Private sector-----7	1817.5
2006-2011	581*	State governments ...119 Private... 462	63,608.27

*Formally approved zones between 2006 and 2011.

Source: Data compiled by the author

Expansion in employment and Investment

Employment (Number)					Investment (Rs. Billion)				
1988	2000	February, 2006	March, 2011	March, 2012	1988	2000	Feb., 2006	March, 2011	March, 2012
25625	81371	129,704	676608		8.97		49.5		2018.75
						17.84		2028.05	

A sharp increase in the share of SEZs in National Exports

Year	National	SEZ (Rs billion)	Share (%)
2005-06	4657.48	228.4	3.17
2006-07	5828.71	346.14	3.78
2007-08	6680.00	663.38	6.43
2008-09	8580.00	996.89	7.41
2009-10	8633.00	2207.11	16.76
2010-11	11395.00	3158.68	18.11
2011-12	14825.00	3644.78	16.82

*: Total national exports are inclusive of service exports

Source: Calculations based data from the Ministry of Commerce and Reserve Bank of India.

Skill intensive and service SEZs proliferated : (Sep, 2010)

Type of SEZ	No. of notified SEZs
Pharmaceutical	18
Engineering	18
Mineral	7
Textiles	12
Multi-product	15
Chemicals	4
Multi-Services	8
Agro processing	9
Footwear	3
Others	3
IT/ITES	206
Bio-technology	18
conventional energy	6
Gems and Jewellery	6
Total	374

But soon the descent began in terms of number and investment

	Approval (No.)	Notified (No.)	In principle approval (No.)	Operational (No.)	Land (hectare)	Units (No.)	Investment (cr)	Employment (No.)
As on 17.07.2012	589	389	48	153	71,502	3,400	380,284 (31.03.2012)	844,916 (31.03.2012)
As on 21.01.2015	491	352	32	196	56,067	3,864	201,875 (as on 30.0.2014)	1,350,071 (as on 30.9.2014)

Was it Economics ?

- **Economics**

- Favourable macro conditions and international conditions (initially)
- Private sector capabilities, outward mobility of capital
- Heterodox approach
- New international division of labour
- Location of SEZs and agglomeration economies
 - SEZs are located in the proximity of industrial clusters
 - SEZs within industrial estates
 - Hybrid SEZs
 - Clusters of small SEZs
- Increasing share of SEZs in exports, employment and investment

Was it a political failure? or Was it a bureaucratic failure?

- **Politics of SEZ**

- Political differences: Confusion at the top levels within the govt
- Mismatch between the ‘inclusive state philosophy’, political haste and public opinion due to issues related to land acquisition, tax revenue, inequities, rent seeking
- Astro turf or grass-root movement?
- Low political returns in the vote bank politics (lack of vision, political will power and strategy)
- Federalism (lack of coordination between the centre and state governments)

- **Bureaucratic failures**

- Confused bureaucrats
- Sheer lack of understanding of SEZs and their potential
- Submission to the politicians’ authority in a democratic set up.

- **Politics mattered.**

Conclusion

- SEZ success calls for
 - coordination between economics, politics and bureaucracy.
 - sound economic rationale supported by long run vision and strategy in place.
 - strong political will power and dynamic approach with favourable public opinion
 - well educated bureaucracy, and
 - A sound implementation strategy

THANK YOU