REVITALIZING INDIA'S SEZs: CHALLENGES AND STRATEGIC POLICY SHIFTS

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1. Introduction

In today's rapidly evolving global economy, nations are constantly seeking innovative ways to attract investment, create jobs, and boost exports. Special Economic Zones (SEZs) have emerged as a cornerstone of these strategies, offering a unique combination of trade regulations and incentives to stimulate economic growth. Inspired by the success of China's SEZ model, India introduced its own version with high expectations. However, despite significant investments and a host of policy initiatives, India's SEZ framework has yet to deliver the anticipated economic benefits. This article explores the evolution of India's SEZ policy, compares it to China's highly successful model, analyzes the challenges and limitations India has faced, and offers recommendations for reform. By doing so, we aim to uncover how India can recalibrate its SEZ policies to foster more sustainable economic growth in the future.

2. Objectives of Special Economic Zones (SEZs)

2.1 Stimulating Economic Activity:

One of the primary objectives of SEZs is to drive additional economic activity by creating an exceptionally business-friendly environment. These zones attract both local and international companies, encouraging them to establish operations within the designated areas. As these businesses expand, both production and consumption levels increase, thereby contributing to robust overall economic expansion in the region.

2.2 Boosting Exports of Goods and Services:

SEZs are strategically designed to enhance exports by offering optimal conditions for manufacturing and service-based enterprises. Companies operating in these zones focus on producing goods and services for international markets, which strengthens the country's trade

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balance and increases foreign exchange earnings. The export-driven model of SEZs is essential for nations aiming to boost their global competitiveness.

2.3 Attracting Domestic and Foreign Investment:

A key goal of SEZs is to stimulate investments from both domestic and international sources. To make these zones attractive to investors, governments offer a suite of incentives such as tax holidays, reduced tariffs, and streamlined regulatory procedures. These benefits help lower operational costs and create an appealing environment for businesses, resulting in a significant inflow of capital into the economy.

2.4 Creating Employment Opportunities:

SEZs play a critical role in generating job opportunities. As companies set up operations within these zones, they require both skilled and semi-skilled labor, thereby generating employment not only within the SEZs but also in related sectors such as logistics, transportation, and services. This employment growth helps reduce unemployment rates and improves the living standards of surrounding communities.

2.5 Enhancing Infrastructure Development:

The establishment and development of SEZs often lead to significant improvements in regional infrastructure. These projects include the development of superior transportation networks, upgraded utilities, modernized communication systems, and enhanced public services. Such advancements benefit both the businesses operating within the SEZs and the broader local population, fostering long-term regional development and sustained economic growth.

3. China's SEZ Model: A Catalyst for Global Transformation

China's SEZ model has been strategically designed to achieve two primary objectives: export-driven economic growth and large-scale infrastructure development. SEZs such as Shenzhen have played a pivotal role in China's economic transformation, serving as dynamic engines of global trade and investment. A key strength of China's approach lies in its seamless integration of national policies with localized autonomy. The government has strategically developed vast SEZs—often established on rural land—ensuring that these zones receive the necessary policy support and infrastructural investments to thrive. Additionally, China has offered a wide range of incentives, including tax exemptions and liberalized labor policies, to attract industries, particularly those that rely on labor-intensive manufacturing. Between 1978 and 2010, SEZs made an enormous contribution to China's GDP growth, exports, and employment generation. As a result, they have been widely recognized as a driving force behind the country's structural economic transformation over the past four decades. Another crucial aspect of China's SEZ success is its long-term commitment to honoring investor incentives. Local autonomous governments have played a vital role in ensuring that these incentives remain flexible and adaptable to evolving global trends and investor needs, thereby fostering a stable and predictable business environment.

4. India's SEZ Model: Challenges and Lessons from China

India's journey with Special Economic Zones (SEZs) began in 1965 with the establishment of its first Export Processing Zone (EPZ) in Kandla, Gujarat, thereby laying the groundwork for subsequent SEZ initiatives. Inspired by China's remarkable success, India formally embraced the SEZ model in its 1997-2002 EXIM policy with the aim of attracting foreign investment, boosting exports, and driving industrial growth. However, India's SEZ program has encountered several obstacles, including inefficient land utilization, inadequate planning, and policy inconsistencies that have hindered its success relative to China's dynamic approach. To unlock the full potential of SEZs, India must refine its strategy by adopting a more flexible, adaptive, and well-integrated framework—one that effectively aligns national policies with local implementation, as demonstrated by China's SEZ success.

5. Limitations of India's SEZ Model

5.1 High Maintenance Costs:

SEZs require substantial government investment, with tax concessions and exemptions amounting to over ₹1 lakh crore between 2006 and 2013. This raises concerns about the long-term financial viability of these zones, especially as the benefits have not always been commensurate with the costs.

5.2 Limited Manufacturing Growth:

While SEZs were intended to drive industrial growth, over 60% of these zones are concentrated in the IT and services sectors, contributing minimally to India's manufacturing expansion. This skewed focus has hindered the broader goal of industrial diversification.

5.3 <u>Employment Gaps</u>:

SEZs were expected to generate millions of jobs, but in reality, job creation has fallen significantly short of the projections, which has undermined one of the main objectives of the SEZ model.

5.4 <u>Unpredictable Tax Policies</u>:

Frequent shifts in tax regulations, such as the introduction of the Minimum Alternate Tax (MAT) and Dividend Distribution Tax (DDT), have eroded investor confidence. These changes have made the business environment less predictable and raised concerns about the long-term stability of SEZs.

5.5 <u>Declining Business Interest</u>:

The removal of tax exemptions has discouraged businesses from setting up operations in SEZs. As a result, many zones remain underutilized, unable to attract the investment they were designed to foster.

5.6 <u>Ineffective Land Utilization</u>:

Almost 50% of the land designated for SEZs remains unused due to sector-specific restrictions, a lack of investor interest, and mismatches between land allocation and the intended use of these zones. This inefficient land utilization has prevented SEZs from reaching their full potential.

6. <u>Key Issues</u>

6.1 <u>Lack of a Phased Approach</u>:

India's approach to SEZs has differed significantly from China's. While China adopted a phased strategy, starting with a few pilot zones and gradually expanding, India pursued large-scale SEZ development without first testing its framework. This lack of a trial phase led to hasty decision-making that overlooked critical challenges like local resistance, infrastructure deficits, and bureaucratic delays. As a result, India faced issues such as land misallocation, policy mismatches, and frequent denotifications, which undermined investor confidence and delayed the full implementation of SEZs.

6.2 Weak Urban Integration:

Another significant reason for the underperformance of India's SEZs is their geographical and infrastructural isolation. In China, SEZs were developed alongside expanding cities, creating synergies between industry, housing, and services. However, many of India's SEZs, such as those in Maharashtra, Rajasthan, and West Bengal, are disconnected from urban centers. These zones suffer from weak integration with regional infrastructure, including inadequate transportation networks, utilities, and social infrastructure, which hinders their ability to develop into self-sustaining economic hubs.

6.3 Political and Public Opposition:

Unlike China's centralized governance, which enabled smooth SEZ implementation with minimal public resistance, India has faced intense political and civil opposition, particularly in relation to land acquisition. The 2006 protests in Nandigram, West Bengal, underscored the widespread backlash against land acquisition policies. Critics argue that inadequate compensation, displacement, and poor rehabilitation efforts have fostered mistrust among affected communities. Additionally, the SEZ policy's allocation of land to private developers led to land speculation, underutilization, and frequent denotifications, as highlighted in Tantri's study. This resistance has significantly slowed the progress and effectiveness of India's SEZ program.

7. Land Utilization in SEZs: A Major Roadblock

India's Special Economic Zones (SEZs) were envisioned as powerful engines of export-led growth, aimed at attracting investment, creating jobs, and boosting industrial production. However, widespread land underutilization has severely hindered their effectiveness. According to Surya Tewari's study, as of 2014, only 37% of the notified SEZ land was in use, with 45% of land in processing zones remaining vacant. This inefficiency is particularly concerning in a land-scarce country like India, where optimal resource allocation is crucial for sustained economic growth.

7.1 Land Hoarding and Speculative Acquisition

One of the key reasons for land wastage in SEZs is speculative acquisition by developers. Many developers acquired large land parcels for SEZs but either left them vacant or repurposed them for non-industrial uses such as real estate, hoping for future capital gains instead of focusing on immediate industrial development. Furthermore, policy flexibility allowing land to be used for non-processing activities—like residential and commercial development—has encouraged land hoarding rather than fostering prompt industrial expansion. In states like Maharashtra, Karnataka, and Tamil Nadu, over 50% of SEZ land remains underutilized due to slow development by private players.

7.2 Ineffective Planning and Industry-Specific Land Allocation

Another significant challenge contributing to land underutilization is ineffective planning and poor industry-specific land allocation. Many states have established large multi-product SEZs without considering the specific industrial needs of the region. As a result, vast portions of land remain unused. In contrast, states like Gujarat and West Bengal have achieved better land utilization by implementing proactive governance and well-structured policies that focus on infrastructure development tailored to regional needs.

7.3 The Need for Reform

To fully unlock the potential of SEZs, India must adopt stricter land allocation policies, ensure better regulatory oversight to prevent speculation, and align SEZ planning with regional industrial ecosystems. Without these reforms, SEZs will continue to fall short of achieving their intended economic impact.

8. Causes of Land Underutilization in SEZs

Several structural and policy-related factors have contributed to the underutilization of land in India's SEZs:

8.1 Speculative Land Acquisition:

Many developers, particularly those involved in private SEZs, acquired vast tracts of land in anticipation of a surge in investor interest. However, the slow pace of investment has left much of this land underutilized. States like Maharashtra and Tamil Nadu, which have some of the highest proportions of unused SEZ land, highlight the gap between allocated land and actual industrial use.

8.2 <u>Sector-Specific Restrictions</u>:

A significant issue is that most SEZs in India are concentrated in the IT and IT-enabled services (IT/ITES) sectors, leaving industries such as manufacturing and agro-processing underdeveloped. This rigid sectoral focus limits the diversification of industries within SEZs. When investor demand does not align with these sector-specific allocations, large portions of land remain unused.

8.3 <u>Inadequate Infrastructure</u>:

Many newer SEZs are hampered by poor infrastructure, including inadequate connectivity, unreliable utilities, and inefficient transport networks. Without essential facilities, businesses face difficulty in establishing operations, leading to reduced investor interest and underutilization of industrial land.

8.4 <u>Policy Instability and Bureaucratic Delays</u>:

Frequent policy reversals—such as the introduction of the Minimum Alternate Tax (MAT) and the removal of key tax exemptions—have created uncertainty among investors. Additionally, the high initial costs of land acquisition have forced some developers to push for policies that would optimize land usage and returns. However, inconsistent policies and shifting investor sentiment have stalled many projects, exacerbating the problem of land underutilization.

9. <u>The Way Forward</u>

To address these challenges, India must implement stricter land allocation guidelines, encourage sectoral diversification, improve infrastructure, and ensure policy stability. Without these measures, SEZs will continue to struggle in realizing their full economic potential.

10. <u>State-Level Success Stories: Lessons for Effective SEZ Utilization</u>

Land utilization in India's Special Economic Zones (SEZs) varies significantly across states, with some regions demonstrating impressive efficiency, while others struggle with severe underutilization. Gujarat and West Bengal stand out as successful examples, achieving far higher land use compared to the national average. In Gujarat, state-promoted SEZs are fully utilized, and West Bengal has recorded a 74% land utilization rate—both significantly better than the national average of just 37% in 2014.

These successes can be attributed to well-crafted state-specific policies, efficient land-use planning, and a diversified approach to SEZ development.

10.1 Gujarat's Infrastructure-Driven Approach

Gujarat's success in SEZ utilization is due to its government-led initiatives, which prioritize infrastructure development and sector-specific incentives. By ensuring robust connectivity, reliable utilities, and fostering a strong industrial ecosystem, the state has created an attractive environment for investors. This proactive approach prevents SEZ stagnation and encourages developers to make optimal use of land rather than holding it for speculative purposes. Gujarat's focused strategy has allowed it to effectively leverage its established industrial base and logistics advantages, turning its SEZs into thriving business hubs.

10.2 West Bengal's Strict Land-Use Policies

In contrast, West Bengal has focused on ensuring that a significant portion of SEZ land is dedicated to processing activities. By limiting non-processing uses and implementing a stringent land-use monitoring system, the state has successfully driven productive engagement within its SEZs. These policies have reduced land hoarding and ensured that land is actively used for industrial purposes. West Bengal's emphasis on enforcing land-use rules and aligning land allocation with industrial growth has led to higher levels of productive utilization compared to many other states.

10.3 Tailored SEZ Strategies: A Key to Success

The experiences of Gujarat and West Bengal demonstrate the importance of customizing SEZ policies to suit regional conditions. Gujarat has capitalized on its industrial base and infrastructure advantages to develop successful multi-product SEZs. Meanwhile, West Bengal has focused on smaller, state regulated SEZs, targeting key sectors like IT and manufacturing. These tailored approaches contrast with states such as Maharashtra and Tamil Nadu, where overly ambitious SEZ expansions, coupled with inadequate investor engagement, have led to widespread land underutilization and frequent denotifications. The distinct strategies employed by Gujarat and West Bengal highlight the need for states to focus on creating region-specific, adaptable SEZ policies.

10.4 Performance-Linked Development: Driving Accountability

A crucial factor in the success of Gujarat and West Bengal is their emphasis on accountability in SEZ development. Gujarat has implemented performance-linked incentives, tying benefits to key metrics such as land utilization, export commitments, and job creation. This has discouraged speculative practices and ensured that SEZs contribute meaningfully to economic growth. Similarly, West Bengal mandates developers to set clear project milestones, maintaining steady implementation and minimizing idle land. By holding developers accountable and aligning incentives with performance, both states have fostered a culture of results-driven development.

10.5 Scaling Success: A Model for Other States

The positive outcomes in Gujarat and West Bengal provide a valuable blueprint for other underperforming states seeking to improve SEZ efficiency. By adopting similar policy mechanisms—focusing on infrastructure, enforcing land-use compliance, and linking incentives to performance—other states can replicate these successes. If these states can implement strategies that encourage proactive development and reduce underutilization, India will be able to tackle the persistent issue of inefficient SEZ land use.

11. Recommendations for Optimizing SEZ Land Utilization

To address the challenges of land underutilization and enhance the overall effectiveness of SEZs, the following policy measures be considered by the Government:

11.1 Phased Land Allotment:

Rather than allocating large tracts of land upfront, land should be distributed in phases based on a developer's progress in meeting investment and employment targets. This phased approach prevents speculation and land hoarding while ensuring that development is timely and productive.

11.2 Expanding Sectoral Scope:

Restrictive sector-specific policies limit SEZ diversification. Broadening the range of permitted industries—including agro-processing, renewable energy, and logistics hubs—can better align SEZ offerings with investor demand, leading to higher land utilization and more diverse economic activity.

11.3 <u>Strengthening Infrastructure Development</u>:

Robust infrastructure—such as transportation networks, reliable power supply, and digital connectivity—is essential for the success of SEZs. Targeted public investments, in collaboration with public-private partnerships (PPPs), can fill infrastructure gaps and create a more conducive environment for long-term investments in SEZs.

11.4 <u>Ensuring Policy Stability and Investor Confidence</u>:

A streamlined, single-window clearance system for SEZ-related approvals can reduce bureaucratic hurdles, boosting investor confidence. Additionally, offering long-term clarity on tax incentives and exemptions will help minimize policy uncertainty, thereby reducing project delays and the risk of investor withdrawals.

11.5 <u>Reallocating Idle Land for Productive Use</u>:

Regular reviews of land utilization are crucial, with underutilized land being reallocated to high-priority sectors or emerging industries. This will ensure optimal use of land resources and maximize economic returns.

By implementing these recommendations and learning from the success stories of Gujarat and West Bengal, India can improve SEZ efficiency, reduce land wastage, and create a more robust framework for sustainable economic growth. The lessons from these states prove that with the right mix of infrastructure investment, strict land-use policies, and performance-based incentives, SEZs can fulfill their potential as drivers of economic development across the country.

12. <u>Denotification of SEZs: Optimizing Land Use for Sustainable Growth</u>

12.1 Special Economic Zones (SEZs) are designated areas where economic regulations are more relaxed than in other parts of the country. These zones are intended to create a business-friendly environment that attracts investment, boosts exports, and drives economic growth. However, when SEZs fall short of these goals, often due to underuse, policy challenges, or market conditions, denotification becomes a crucial tool to address these inefficiencies.

12.2 Denotification is the process of revoking the SEZ status of an area, or part of it, returning it to its original status under standard economic laws. This allows the government and developers to repurpose land and resources for more productive uses, especially when the SEZs are underperforming or remain unused.

12.3 In India, the Special Economic Zones Rules, 2006, regulate the establishment, operation, and denotification of SEZs. Section 8 of these rules outlines the process for both granting and withdrawing SEZ status under certain conditions. Developers can apply for denotification if their projects do not materialize or if there are better economic alternatives. The final decision on revoking the SEZ status is made by the Central Government, usually after recommendations from relevant authorities.

12.4 Developers seeking to denotify an SEZ must apply in Form C6 to the Development Commissioner, who will review the application within 15 days and forward it with recommendations for further consideration.

When applied strategically, denotification helps minimize wasteful land and capital use by repurposing underperforming SEZs for more productive economic activities. This process is key to addressing the long-term sustainability issues often associated with SEZs, such as land underutilization. Through effective denotification, India can reduce resource misallocation, ensuring that underused assets are redirected to sectors that can foster growth, innovation, and job creation.

13. **Reasons for Denotification of SEZs**

13.1 **Economic Viability**:

(i) **Market Fluctuations**: Global economic shifts, such as a decline in export demand, can render an SEZ financially unfeasible. For instance, during the 2008 global financial crisis, a sharp decrease in exports led to several SEZs considering denotification as a viable option.

(ii) **High Operational Costs**: The costs of maintaining SEZ infrastructure and ensuring regulatory compliance may surpass the anticipated benefits, especially when investments and exports fall short of projections.

13.2 **Policy Changes**:

(i) **Withdrawal of Tax Incentives**: In 2011-12, the introduction of the Minimum Alternate Tax (MAT) and Dividend Distribution Tax (DDT) reduced the attractiveness of SEZs to investors, making it challenging for developers to sustain operations.

(ii) **Revised Land Use Regulations**: Changes in zoning laws can make it more lucrative to repurpose SEZ land for residential or commercial real estate, prompting developers to apply for denotification.

13.3 Infrastructure Deficiencies:

(i) **Inadequate Connectivity**: SEZs require robust infrastructure such as roads, ports, and utilities. When these facilities remain underdeveloped, SEZ operations suffer, often leading to denotification requests.

(ii) **Delayed Development**: Bureaucratic delays and lack of investor interest can stall SEZ development, making denotification a practical alternative to mitigate further loss.

13.4 Legal and Regulatory Challenges:

(i) **Land Acquisition Disputes**: Prolonged legal battles over land acquisition can significantly delay or halt SEZ projects, prompting developers to opt for denotification.

(ii) **Non-Compliance with Regulations**: SEZs must be used for designated purposes, and non-compliance—such as misuse of land for unauthorized activities or failure to meet export obligations—can lead to the revocation of SEZ status under the SEZ Act, 2005.

14. Case Studies of SEZ Denotification

14.1 Mahindra World City, Jaipur (India):

(i) **Overview**: Mahindra World City (MWC) Jaipur, developed as a joint venture between the Mahindra Group and the Rajasthan State Industrial Development and Investment Corporation (RIICO), was envisioned as a multi-sector SEZ focusing on IT/ITES and manufacturing.

(ii) **Reasons for Denotification:**

- **Oversupply of IT/ITES Space**: A slowdown in the IT/ITES sector in India, combined with factors like automation and reduced outsourcing demand, resulted in an excess of office space. The SEZ struggled to attract tenants.

- **Shifting Market Trends**: Companies increasingly preferred non-SEZ locations due to lower operational costs and fewer compliance requirements.

- **Higher Returns from Alternative Use**: The developer sought to repurpose SEZ land for mixed-use purposes, including residential and commercial developments.

(iii) **Sequel**: The denotified portion of MWC Jaipur was repurposed to accommodate a broader range of industries, boosting its commercial viability.

14.2 <u>Navi Mumbai SEZ (India)</u>:

(i) **Overview**: Promoted by Reliance Industries, the Navi Mumbai SEZ was designed as a 10,000-hectare multi-product SEZ, intended to strengthen India's manufacturing and services sectors. However, the project faced numerous obstacles.

(ii) Reasons for Denotification:

- **Loss of Tax Benefits**: The introduction of MAT and DDT in 2011-12 eroded the financial incentives that initially made SEZs attractive to investors.

- **Global Economic Slowdown**: Following the 2008 recession, investor interest in the SEZ diminished, causing delays in the project's execution.

- **Land Acquisition Disputes**: Resistance from local farmers and legal challenges further hindered development.

- **Business Strategy Shift**: Reliance Industries shifted its focus to higher-growth sectors, such as telecommunications (Jio) and retail, deprioritizing the SEZ.

(iii) **Sequel**: The denotification of Navi Mumbai SEZ resulted in the repurposing of the land for industrial and commercial use.

14.3 <u>Shenzhen SEZ (China) – A Case of Partial Denotification</u>:

(i) **Overview**: Shenzhen, established as an SEZ in 1980, transformed from a small fishing village into one of the world's most successful economic hubs, driven by favorable policies, infrastructure development, and strategic location.

(ii) Reasons for Partial Denotification:

- **Redevelopment of Outdated Areas**: Older industrial zones were repurposed to accommodate modern infrastructure and high-tech industries.
- **Economic Transformation**: Shenzhen evolved from low-cost manufacturing to an advanced technology and innovation-driven economy, necessitating a reallocation of land.
- **Urbanization Demands**: Rising population levels created increased demand for residential and commercial spaces, leading to land repurposing.
- **Environmental Considerations**: Certain areas were denotified to support the development of sustainable, eco-friendly infrastructure.

(iii) **Sequel**: The partial denotification allowed Shenzhen to retain its position as a global economic powerhouse by adapting to changing economic and social priorities, while meeting the demands of a growing population and evolving market conditions.

15. <u>Comparative Analysis of the Case Studies</u>

Aspect	**Mahindra World City, Jaipur**	**Navi Mumbai SEZ**	**Shenzhen SEZ**
Primary Reason	Oversupply of IT/ITES space	Withdrawal of tax benefits	Redevelopment of older areas
Key Challenges	Market slowdown, underutilization	Global slowdown, land acquisition	Urbanization, changing priorities

Aspect	**Mahindra World City, Jaipur**	**Navi Mumbai SEZ**	**Shenzhen SEZ**
Consequence	Repurposed for mixed-use development	Land repurposed for other industries	Modernized infrastructure
Policy Impact	Highlighted need for flexible SEZ policies	Led to debates on SEZ tax reforms	Showcased adaptability of SEZ model

Denotification is an essential policy tool that allows the reallocation of underutilized SEZ land for more productive purposes. By learning from successful case studies such as Mahindra World City, Navi Mumbai SEZ, and Shenzhen SEZ, India has the opportunity to develop a more flexible and responsive SEZ framework. To ensure the long-term success of SEZs while minimizing inefficiencies, future policies must prioritize infrastructure development, regulatory stability, and diversification.

16. Missed Opportunities: SEZs and the Agricultural Sector in India

India's SEZ policy has primarily focused on sectors such as IT, ITES, manufacturing, and specific fields like Agri-tech, rural-tech, and biotechnology, while overlooking the integration of the agricultural sector into SEZs. This gap represents a missed opportunity, especially considering India's agrarian roots and its vast potential for agro-based exports. The failure of Agricultural Export Zones (AEZs), which were introduced as part of the 1997-2002 EXIM policy alongside SEZs, further highlights the challenges in harnessing agricultural growth through specialized zones.

16.1 Challenges of Agricultural Export Zones (AEZs) and Key Lessons for SEZs:

AEZs were intended to add value to agricultural products and promote agro-based exports but fell short of achieving these goals due to several critical challenges. First and foremost, AEZs lacked sufficient institutional support, and their infrastructure was ineffective. In contrast to SEZs, which benefitted from strong government backing, generous incentives, and extensive financial support, AEZs were left with limited fiscal advantages and struggled to attract investment. Additionally, AEZs lacked strong connections to global supply chains, which significantly hindered their growth.

This situation underscores the potential for the SEZ model to bridge the gap by incorporating the agricultural sector within SEZs. By extending the SEZ framework to agriculture and agro-processing, significant value can be added to the agricultural sector, especially when food processing, logistics, and cold storage infrastructure are included. Such integration could not only enhance agro-based exports but also stimulate rural development. By addressing regional development disparities, agro-based SEZs could drive inclusive economic growth, particularly in rural and semi-urban areas.

16.2 Policy Guidelines for Agro-Based SEZs:

(i) To effectively integrate the agricultural sector into SEZs, the following policy initiatives should be considered:

- **Specialized Agro-Processing SEZs**: Establish SEZs in regions with high agricultural productivity, focusing on food processing, packaging, and export. These specialized SEZs can provide targeted support to the agricultural value chain, enhancing agro-based exports.

- **Strengthening Logistics and Cold Chains**: Invest in the development of logistics hubs and cold storage facilities that are critical for the transportation, storage, and preservation of perishable agricultural products. These infrastructure improvements will reduce wastage and ensure products reach international markets in optimal condition.

(ii) By implementing these policy initiatives, India can create agro-based SEZs that promote agricultural growth, bolster exports, and address regional imbalances. Through strategic planning, these SEZs can become pivotal in strengthening India's agricultural sector while ensuring long-term economic sustainability and rural development.

17. WTO Compliance Challenges

17.1 The World Trade Organization (WTO) Subsidies and Countervailing Measures (SCM) Agreement prohibits subsidies that are tied to export performance. For a subsidy to be considered legal under this agreement, it must meet specific criteria. A "subsidy" refers to any financial support provided by a government or public body that benefits businesses, such as direct cash payments, tax exemptions, or government-provided services. However, subsidies aimed at boosting exports or promoting local content (i.e., favoring domestic goods over imports) are prohibited under the SCM agreement. If a subsidy unfairly benefits certain businesses, industries, or regions at the expense of other countries, it is considered "actionable" and can be legally challenged.

17.2 India's current SEZ system provides benefits like tax exemptions to businesses that generate foreign exchange through exports. These benefits, including exemptions from sales tax, service tax, and customs duties, are linked to export performance, which creates a conflict with WTO rules. Since these incentives are contingent on export outcomes, they violate WTO regulations on subsidies.

17.3 In October 2019, the WTO ruled against India in a case filed by the United States, which challenged India's export subsidies. The U.S. argued that the customs duty, tax, and income tax exemptions granted to SEZ businesses violated WTO rules. The WTO directed India to remove these prohibited subsidies within 180 days. This ruling was the first to specifically address SEZ incentives under WTO subsidy rules.

17.4 Other countries, including the U.S. and China, have also faced similar WTO challenges regarding their SEZ policies. However, many of these nations managed to avoid penalties by adjusting their policies to appear WTO-compliant, even if their core practices remained unchanged. The fundamental issue is that India's SEZ incentives are directly tied to export performance, which violates WTO subsidy rules. The WTO continues to monitor SEZ schemes globally and challenges those that offer export-based subsidies.

18. WTO Compliance: Global Case Studies and Insights:

Countries that have established SEZs to promote exports have encountered challenges related to WTO rules on export performance-based subsidies. While India has faced unfavorable rulings, countries like China and Mexico have also faced similar challenges, navigating them with varying degrees of success. These cases offer valuable lessons that could help India develop WTO-compliant policies.

18.1 China's Strategy: Balancing Compliance and Innovation

China's SEZs have faced WTO challenges, particularly related to subsidies for land-use rights, tax breaks, and discounted infrastructure costs in industrial parks. Mexico raised concerns about China's tax incentives and land discounts provided to businesses in SEZs. While the issue did not escalate beyond consultations, it underscores how China managed to address potential disputes.

China responded by restructuring its subsidies to comply with WTO rules. For example, it reclassified certain incentives, such as general infrastructure support and research grants, which are permitted under WTO provisions. India can adopt a similar strategy by focusing less on export-linked benefits and instead promoting more neutral forms of support, such as infrastructure development and skill enhancement, to remain in line with WTO standards.

18.2 <u>Mexico's Strategy: Consultation and Domestic Policy Adjustments</u>

Mexico also faced WTO challenges regarding its SEZ subsidies, particularly those related to tax incentives and infrastructure support for export-oriented businesses. However, Mexico avoided formal penalties by engaging in strategic consultations with relevant stakeholders and making necessary adjustments to its domestic policies.

Mexico's approach highlights the importance of engaging with the WTO's dispute settlement mechanism. By consistently monitoring the impact of its SEZ policies and making proactive reforms before issues escalate, Mexico has been able to maintain its SEZ benefits while staying compliant with WTO guidelines.

18.3 <u>The United States: Altering Policies to Minimize Risks</u>

The U.S. has faced WTO challenges related to regional subsidies in its industrial parks and SEZ-like zones. In response, the U.S. revised many of its support programs to focus on job creation and regional development rather than export performance. This policy shift allowed the U.S. to comply with WTO rules while continuing to advance its domestic interests.

The key lesson from the U.S. example is that subsidies based on non-export criteria, such as research and development or local employment, can achieve economic objectives without violating WTO rules. This approach could serve as a model for India, where shifting the focus from export-contingent benefits could help align India's policies with WTO standards while still promoting growth and development.

18.4 <u>Implications for India</u>

India can draw valuable insights from international experiences to reformulate its SEZ framework in compliance with WTO guidelines. Key steps for this reform include:

(i) **Revising Incentives**: Shift from export-contingent incentives to broader support measures, such as tax rebates for research, job creation, and sustainability initiatives. By making these changes, India can create a more WTO-compliant environment that still promotes domestic economic growth.

(ii) **Strengthening Monitoring and Engagement**: Allocate more resources to monitoring SEZ subsidies to ensure compliance with WTO rules. Proactively engage in WTO consultations to stay ahead of potential challenges and address issues before they escalate.

(iii) **Adjusting Sectoral Benefits**: Ensure that grants and incentives targeting sectors with high domestic growth potential—such as renewable energy, technology parks, and innovation hubs—are WTO-compliant. By aligning incentives with broader policy goals, India can avoid the pitfalls of export-based subsidies.

By taking these steps, India can reduce the risk of future WTO disputes and continue to leverage its SEZ policy as a tool for economic growth and investment. These reforms will ensure that India remains competitive in the global market while adhering to international trade regulations.

19. <u>WTO Regulations: Approaches by Other Countries</u>

19.1 India is not the only country under scrutiny by the World Trade Organization (WTO) concerning its Special Economic Zones (SEZs). Countries such as China and Mexico have also faced challenges related to the subsidies provided within their SEZs. For example, China encountered concerns from Mexico over subsidies like tax incentives and discounted land-use rights. While these disputes did not escalate beyond consultations, they highlight the potential risks involved in offering export-based subsidies within SEZs.

19.2 Similarly, in the U.S.-China dispute, the WTO determined that certain regional subsidies in industrial parks violated WTO rules. Despite these challenges, SEZs can still operate within the guidelines of the WTO without violating the Subsidies and Countervailing Measures

(SCM) Agreement. There are several types of SEZ incentives that are permissible under WTO rules, such as:

(i) **General Infrastructure Support**: Providing essential infrastructure—like roads or utilities—to SEZs does not count as a prohibited subsidy.

(ii) **Properly Designed Border Tax Adjustments and Duty Drawbacks**: Exemptions or remissions on taxes for exported goods, provided they are reasonable, do not violate WTO rules.

(iii) **Support for Emerging Markets**: Government assistance for nascent sectors, such as renewable energy, may not be considered a subsidy if the market is still too underdeveloped to establish appropriate benchmarks.

These examples show that it is possible for countries to maintain SEZs and continue to offer incentives while staying within WTO guidelines, provided the focus shifts from export-based benefits to more neutral forms of support, like infrastructure and market development.

20. India's SEZ Reform Initiatives

In response to concerns raised by the WTO, India has started to reform its SEZ policies. A key development in this regard is the introduction of the Development of Enterprise and Service Hubs (DESH) Act in 2022, which aims to replace the SEZ Act of 2005. The new framework moves away from export-based incentives and instead proposes a more inclusive development model, including renaming SEZs as "Development Hubs." However, the implementation of this framework has been delayed due to concerns over customs regulations and central control.

21. SEZ Policy Recommendations

To enhance the effectiveness of India's SEZs while ensuring compliance with WTO regulations, the government should consider the following measures:

21.1 **Adopting Bonded Manufacturing Spaces**: These would allow for duty-free access to raw materials without any export conditions, making it easier for businesses to operate and ensuring compliance with WTO rules.

21.2 **<u>Introducing Smart Incentives</u>**: Instead of focusing on export targets, incentives should be linked to areas like research and development, employment generation, and sustainability efforts.

21.3 **<u>Developing Integrated Economic Hubs</u>**: Strengthening urban infrastructure to support SEZs is key. Developing economic hubs that integrate industrial activity with logistics, transport, and service industries would help create a more robust, self-sustaining system.

21.4 **<u>Conducting Experimental Programs</u>**: Testing policies in a controlled environment before nationwide implementation can help assess their effectiveness and minimize unforeseen consequences.

21.5 **<u>Ensuring Transparent Land Acquisition</u>**: Fair policies for land acquisition should be adopted, ensuring adequate compensation and rehabilitation for displaced communities, which would help maintain social stability and foster investor confidence.

22. <u>Rebranding SEZs: From Export Zones to Development Hubs</u>

In 2022, India took a significant step toward rethinking its SEZ policy with the introduction of the DESH Act, which proposes a shift from export driven SEZs to a more holistic approach through the concept of "Development Hubs." This framework aims to address the limitations of traditional SEZs, which focused primarily on export-led growth, by expanding the role of SEZs to include domestic market integration, technological innovation, and sustainable development.

22.1 <u>Comparison of SEZs with Development Hubs</u>:

Traditional SEZs in India were designed to attract businesses that generated foreign exchange through tax exemptions and duty-free imports. However, this export-focused model faced several challenges, including WTO compliance issues, a lack of flexibility across sectors, and dependence on international markets. The Development Hubs framework seeks to overcome these issues by promoting a more comprehensive development model that supports both domestic and international market integration.

22.2 <u>Under the DESH Framework: Key Features</u>:

(i) **Relaxation of Export Restrictions**: Unlike traditional SEZs, which focused exclusively on export-oriented units, Development Hubs accommodate both export-driven and domestically oriented businesses. This flexibility reduces reliance on international markets and encourages a stronger focus on domestic demand.

(ii) **Integrated Economic Growth**: Development Hubs promote regional development by linking industrial activity with strong urban infrastructure, logistics hubs, and service industries, creating a more interconnected and resilient economy.

(iii) **Encouraging New Sectors**: The DESH Act supports emerging sectors such as renewable energy, technology, and agro-processing by offering WTO-compliant incentives, such as infrastructure grants and research support, to foster innovation and growth in these industries.

22.3 <u>Implications of the Rebranding</u>:

The shift from SEZs to Development Hubs comes with several potential benefits and changes for India:

(i) **WTO Compliance**: By moving away from export-based subsidies, India can significantly reduce the risk of future WTO disputes, particularly with countries like the U.S. This can be achieved by focusing on broader incentives such as tax rebates for job creation, research, and sustainability initiatives.

(ii) **Regional and Rural Development**: The Development Hubs model encourages the establishment of agro-processing and manufacturing industries in underdeveloped regions, thus promoting balanced and inclusive regional development.

(iii) **Rehabilitation of SEZs into Development Hubs**: By converting existing SEZs into Development Hubs, India can better harness its competitive advantages, address regional disparities, and integrate its economy more effectively into both domestic and global value chains.

23. <u>Outlook</u>

23.1 India's SEZ strategy has faced significant challenges, including rushed implementation, poor planning, frequent policy changes, and issues related to WTO compliance. Despite their potential to boost exports, attract foreign investment, and transform India's industrial landscape, these shortcomings have limited the effectiveness of SEZs. The introduction of the DESH framework presents an opportunity to address these issues and unlock the full potential of India's SEZs.

23.2 By shifting the focus from export-driven growth to a more inclusive and sustainable development model, India can foster economic growth, create jobs, and promote long-term prosperity. Strategic reforms, such as reallocating idle land, introducing targeted sectoral incentives, investing in infrastructure, and adopting WTO-compliant policies, will help revitalize the SEZ model. If implemented effectively, Development Hubs can become powerful engines of economic growth that drive regional development and foster both domestic and global competitiveness.

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