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What is the difference between SEZs and EPZs, The Indian EPZs experience.

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Abstract:

The EPZs in India were developed, owned and managed by the Central Government. The scope of the permitted activities for operating in the zone was initially limited to processing or manufacturing with project wise specified value addition norms for strict compliance. The scope was subsequently expended to include activities like trading, re-conditioning and re-engineering in the zone also with specific value addition guideline. A new policy was introduced in the Export and Import policy effective form April 1, 2000 for setting up of Special Economic Zone in the country with a view to provide an internationally competitive and hassle free environment for export. This paper aimed to show the difference between SEZ and EPZs and its Indian experience.

Key words: Central Sale Tax (CST), Domestic Tariff Area (DTA), Deduction of Direct Tax (DDT), Export Oriented Units (EOU), Electronics Hardware Technology Park (EHTP), Indian Rupees (INR), Minimum Alternative Tax (MAT), Special Economic Zone (SEZ), Software Technology Park (STP), export processing zones (EPZs), Foreign Direct Investments (FDI)

Introduction:

An Export Processing Zone ("EPZ"), these zones are similar to SEZ in that they encompass large land estates that focus on foreign exports, but they differ in that they do not provide the same degree of tax benefits or regulatory leniency. They instead provide a functional advantage to investors seeking to capitalize on the economies of scale that a geographic concentration of production and manufacturing can bring to a trade region. These zones are beneficial to a host country, if they are successful, because the host country does not have to provide reduced tariffs or regulations but it still benefits from increased trade to the region.

Special Economic Zones are generally classified as zones that promote increased, streamlined trade through beneficial taxation schemes and reduced customs oversight, but many nuances have developed within this broad framework to accommodate specialized industries, working conditions, country infrastructure, government oversight, and geographies.

Analysis:

SEZs are large variant of EPZs. Both have a delineated area permit duty free import of capital goods and raw materials, both aim to attract foreign investment for setting up export-oriented units by providing developed infrastructure, conducive operating environment and a package of fiscal incentives. However, the objective of SEZs in much large than mere promotion of export processing activities. While EPZs are industrial estates, SEZs are virtually industrial townships that provide supportive infrastructure such as housing, roads, port and telecommunications hospitals, hotels, educational institutions, and entertainment units, residential/ industrial/ commercial complexes, water supply sanitation and sewerage system and any other facility required for development of the zone.

The scope of activities that can be undertaken in the SEZs in much wider and their linkages with the domestic economy are stronger. Resultantly they have a diversified industrial base. Their role is not transient like EPZs, as they are intended to be instrument of regional development as well as export promotion. Although the objectives of SEZ policy are quite similar to the objective envisaged by central government though EPZs policy in early eighties but there significant difference between these two policies in terms of tax benefits and rules and regulations.

Table-1.1 is showing the difference between SEZ and EPZ

	Indian's SEZ	**Indian's EPZ**	**SEZ vs. EPZ**
Restriction on sectors	Open to manufacturing, services and trading activities.	Open to manufacturing and trading activities. Services may also be considered.	While SEZs are generally open to all activities, EPZs apper to focus more on manufacturing and trading.
Tax exemption	Companies in SEZs enjoy a 5 year corporate tax holiday, followed by 50 % exemption for 2 more years.	Companies in EPZs were exempted from corporate tax for a block of 5 year in first 8 years of operations. However, under	SEZs offer more attractive tax benefits than EPZs.

		section 10a of the income tax act, the concession was to be phased out by 2009.	
Retention of foreign exchange earnings	Retain 100% foreign exchange earning in exchange earner foreign currency account(EEFC).	Retain 70% foreign exchange earning in exchange earner Foreign Currency account(EEFC).	Companies in SEZs would have better control over foreign currency in relation to purchase of imported inputs.
Export performance (EP) & Net foreign exchange earnings as % of export requirements.	No minimum export performance required. Positive net foreign exchange earning required (varies across industrial and states).	Minimum export performance and net foreign exchange earning required (varies across industrial and states).	Companies in SEZ enjoy more leeway in meeting export performance requirements.
Duty recovery in case of failure to achieve positive net foreign exchange earning	Duty recovery is in proportion to shortfall.	Full duty recovery is imposed.	Lesser penalty for SEZs falling to achieve positive net foreign exchange earnings.
Duty free imported raw material	Allowed, these duty free materials are to be utilized over 5 year.	Allowed but duty free materials are to be utilized over 1 year.	More flexibility in production and inventory planning for companies in SEZs.
Certification of imports	Imports on self-certification basis.	Imports require attestation	Simplified customs procedures facilitate

		development commissioner.	movement of imports into SEZs
Customs inspection	No routine exemption of import/export cargo by customs	Routine customs inspection of import/ export cargo	Expedited movement of goods in an out of SEZs
FDI approval process	100% FDI investment through automatic route available for manufacturing companies	Foreign investment promotion board approval is required for FDI	Easier and quicker FDI flows into SEZs for manufacturing companies.

Sources: SEZ Authority, Ministry of Commerce and Industry, Government of India available at www.sezindia.nic.in accessed on June 5, 2006.

The Indian EPZs experience:

EPZ exports increased in India from less than Rs.1 million in 1966 to over Rs. 97727 million in 2002. Over the same period, total employment increased from 70 to around 89,000, net foreign exchange earnings increased from Rs. 0.16 million to Rs. 43195 million and value addition increased from 21% to 44%.

While these big figures seem impressive a closer look at the details reveals several serious problems. First of all the average annual growth rate of value addition in the EPZs was as low as 2.9% which means that the companies operating in these zones were basically exporting out almost as much as they imported without significant addition to the value of goods produced. The EPZs thus contributed little to improvement of skills or transfer of technical know-how in the domestic market.

Again despite the overall growth of exports from EPZs in absolute terms their actual share in total national exports and manufactured exports increased from .07% and .14% respectively in 1973 to just 4.3 % and 5.6% respectively in 2001. This is in contrast to countries like Bangladesh and Sri Lanka , where EPZs contributed to over 20 percent of overall exports by the year 2000 or to Mexico where they make up 40 percent of national export figures. The Indian EPZs clearly failed to induce dynamism in the overall export performance of the national economy.

On the employment front too after an initial spurt in numbers of people getting jobs in the EPZs there has been a general decline and even stagnation. So for example while employment in the EPZs grew at the rate of over 50.2 percent between 1966 and 1970 it declined to a mere 5.2 percent between 2000 and 2002.

Even assuming that the EPZ/SEZs do result in an increase in exports and even hard currency earnings their real performance can be measured only by taking into account the amount of revenues foregone by the government in the form of various incentives. According to an internal assessment of the Union Finance Ministry in 2005, the government had to forgo about Rs. 90,000 crore in direct and indirect taxes over a period of four years on account of the SEZs.

If one takes into account the money spent by the government on actual construction and maintenance of these EPZ/SEZs the situation is even worse. The 1998 Comptroller and Auditor-General Report on EPZs, stated that "customs duty amounting to Rs.7, 500 crore was forgone for achieving net foreign exchange earnings of Rs. 4,700 crore and the government does not seem to have made any cost benefit analysis."

Table-1.2 shows the how many EPZ converted into SEZ after SEZ Policy was announced.

List of all the EPZs converted into SEZs with their size

Location	**Size (Sq.KM)**

Kandla(Gujarat)	2.99
SEEPZ(Mumbai)	0.38
Cochin(kerala)	0.40
Surat(Gujrat)	NA
Noida(UP)	1.22
Chennai(TN)	1.04
Vizag(AP)	1.43
Falta(WB)	1.12

Source: Export Promotion Council, Ministry of Commerce, Government of India

Conclusion:

The modern day Special Economic Zone came in to existence because the economic reforms incorporated in the early 1990s did not resulted in the overall growth of the Indian economy. The SEZ policy of India was devised to act as a catalyst to promote the economic growth attained in the early 1990. The economic reforms incorporated during the 1990s did not produce the desired results. The Indian manufacturing sector witnessed a sudden dip in the overall growth of the industry, during the second-half of 1990s. The History of SEZs in India suggests that red tape, lengthy administrative procedures, rigid labor laws and poor physical infrastructural facilities were the main cause of deterioration of Foreign Direct Investments (FDI) inflow in to India. Further, the Indian markets were not mature enough to facilitate easy entry of Foreign Institutional Investors (FIIs) in to the Indian economic system. Furthermore, the legal framework of Indian economy was not strong enough to prevent misuse of Indian markets by the foreign investors. Thus, the lack of investor friendly environment in India prevented growth of Indian industry, in spite of implementation of liberal economic policy by the central government. This resulted in the formation of a much larger and more efficient form of their predecessors with world-class infrastructural facility.

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