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## SEZ IN INDIA: CURRENT TRENDS AND IMPACT ASSESSMENT ON SUNSET CLAUSE

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### **Abstract**

Many developing nations have embraced special economic zones (SEZs) as a tool for policy to encourage industrialization and economic development. The World Development Report 2020 acknowledges the potential of SEZs as a tool for facilitating participation in the global value chain. SEZs in developing nations have had a generally mixed record as a "high-risk, high-reward" device. Some countries or regions have drastically different results. An SEZ is intended to support market forces by assisting in the resolution of market imperfections as a tool for industrial policy. Even when a zone approach is required and practical, the host government must still choose which kind of zone is best. SEZs frequently entail a "special" legal and regulatory framework, and they may be acceptable if the primary restrictions are connected to legal and regulatory difficulties that, in addition to other constraints, have an impact on the business environment. Following the current trends, the paper entails the implication of government withdrawal on its schemes and sunset clauses as well as impact assessment of the sunset clause.

**Key words:** Special Economic Zone, Industrial Development, Industrialization, Development Strategy

### **I. INTRODUCTION**

Special economic zones (SEZs) or industrial parks can be an effective tool for the promotion of industrialization and structural transformation when applied in the right context.

It has been over 50 years with special export zones and it yields a mixed picture. It has witnessed success in regions of Asia and disappointments in areas of Sub-Saharan Africa. This has created a ruckus about the rationale and justification for using SEZs as a tool for economic development.

These zones demand cautious development because they are expensive and risky projects. Instead of being an instrument for economic development, they can be used for political speculation, and some "white elephant" zones completely collapse.

### **II. CONCEPTUAL FRAMEWORK**

- A. Special Economic Zone (SEZ) is defined as "a specifically delineated duty-free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs". SEZs are an acknowledgement of the potential of export-led development strategy in accelerating economic growth.
- B. Free Trade Zones: FTZs also known as commercial-free zones are fenced-in, duty-free areas, offering warehousing, storage and distribution facilities for trade, transshipment, and re-export operations.
- C. Export Processing Zones: EPZs are industrial estates aimed primarily at foreign markets. They offer firms free-trade conditions and a liberal regulatory environment. There are firms free-trade conditions and a liberal regulatory environment. There are in general two types of EPZs: first is comprehensive type, open to all industries; another is specialized type, only open for certain specialized sectors/products.
- D. Comprehensive Processing Zones: Comprehensive SEZs also known as Multi-functional Economic Zones are zones of a

large size that have a mix of different, industrial, service and urban-amenity operations.

- E. Industrial Parks: Industrial Zones are largely manufacturing based sites. Some multi-functional ones similar to Comprehensive Special Economic Zones exist, but usually operate at a smaller scale. The parks normally offer a broad set of incentives and benefits.
- F. Bonded Area: Bonded Warehouses are particular buildings or other safe locations where commodities may be stored, handled, or put through production processes without having to pay the tariffs that would otherwise be levied. Bonded area is similar to free trade zone. The difference lies that bonded area is subject to custom laws and regulations, while a free trade zone is exempt from these provisions.
- G. Specialized Zones: These include science/technology parks, petrochemical zones, logistics parks and airport-based zones.
- H. Eco-Industrial Zones or Parks: Eco-industrial zones focus on ecological improvements in terms of reducing waste and improving the environmental performance of firms. To achieve energy and resource efficiency, they frequently deploy green technologies and the "Industrial Symbiosis" idea. More nations are embracing this new kind of zone as a result of the serious environmental concerns.

### 1. Meaning and Definition of Special Economic Zones

Special Economic Zones i.e., the SEZs also known as industrial parks are all around the world. A geographical region encompassing more liberal economic laws than a country's typical economic laws can be referred to as a Special Economic Zone (SEZ). These Special Economic Zones are an effective tool in order to encourage industrial development. Countries all across the globe create a fenced-in, geographically delimited 'enclaves' within sovereign territories. These enclaves are known

as 'zones' in economic and business parlances. Some of these zones are often intentionally known as 'foreign' territories functioning with a different set of economic laws compared with those applicable to the rest of the country.<sup>951</sup> These zones have various names such as free trade zone (FTZ), export processing zone (EPZ), enterprise zone, or free economic zone (FEZ).

The four basic features of SEZ concept are:

- i. It is a physically secured, geographically defined territory;
- ii. It has a single management or administration;
- iii. It aids for investors physically within the zone; and
- iv. It has a separate customs area (duty-free benefits) and streamlined procedures (FIAS, 2008)

The promotion of SEZs is expected to tackle wide range of structural bottlenecks created by monetary, fiscal, taxation, trade, tariff and labour policies, apart from overcoming complex procedures and infrastructure deficiencies.<sup>952</sup>

### III. ISSUES INVOLVED

- A. To analyze whether SEZs are Effective in driving Private sector development.
- B. To understand the likely impact of establishment of SEZs on agricultural production, employment, water and food security.
- C. To understand the risks of SEZ policies in low-income countries and what strategies will enable developing countries to minimize those risks and harness the power of SEZs to stimulate growth.

### IV. JUDICIAL PERSPECTIVE

The first modern industrial SEZ was established in Shannon, Ireland in the year 1959. In the 1970s, East Asian and Latin American regions began establishing such zones originally in the form of export processing zones (EPZs) to attract

<sup>951</sup> Palit, A. and Bhattacharjee, S. (2008) *Special economic zones in India: Myths and realities*. New Delhi: Anthem Press.

<sup>952</sup> Aggarwal, Aradhna (2006), "Special Economic Zones: Revisiting the Policy Debate", *Economic and Political Weekly*, Vol.41, Nos. 43-44, November 4, pp. 4533-4536.

foreign direct investment in labour intensive manufacturing sectors to encourage sports.<sup>953</sup>

A policy of setting up of SEZ was introduced in India on April 1, 2000 with a view to providing a more competitive free trade environment for exports. During the period from November 1, 2000 to February 9, 2006, the SEZs in India operated under the provisions of the Foreign Trade Policy. India was the first Asian country to recognise the importance and effectiveness of Export Processing Zone (EPZ) and the first EPZ came into being in 1965 in Kandla, Gujarat.

#### A. Constitutional validity of the SEZ Act

The constitutional validity of the SEZ Act, has been pending consideration before the Supreme Court in *Kuldeep Bishnoi v. Union of India*.<sup>954</sup> The Union Government, states, and union territories received notices from the Supreme Court in the public interest litigation contesting the taking of cultivable land from farmers for the development of SEZs under the pretext of a public purpose. The main argument made by petitioner Kuldeep Bishnoi before a bench made up of Judges K.G. Balakrishnan and D.K. Jain was that the National Capital Region (NCR), which includes Delhi and areas from three different states, namely Haryana, Rajasthan, and Uttar Pradesh, including agricultural land, is subject to legislation from the Centre under Article 252 of the Constitution.

The petitioners questioned the constitutional validity of sections 3(f), 4 and 6 of the Land Acquisition Act, 1894 that authorized the governments to acquire agricultural land for 'public purpose' for builders, developers and industrialists denuding poor farmers and cultivators of their land and livelihood, forcing them to commit suicides. The petitioners said "economic growth is required but not by impoverishing people. That is what is happening because most displaced persons who lack the skills required for industrial jobs and other benefits are impoverished to the

benefit of another class." The Kuldeep Bishnoi case has been linked to multiple writ petitions that were submitted to several high courts, including the Supreme Court.

In the case of *Bondu Ramaswamy v. Bangalore Development Authority*<sup>955</sup>, the supreme court took an active role. All writ petitions from all high courts have been transferred to the Kuldeep Bishnoi case. It was submitted in 2006, not long after the Act went into effect. Keeping the cases unresolved indicates the supreme court's "inaction" and "inappropriate" attitude for one of its magnitudes. The constitutionality of the SEZ Act and the ensuing acquisition of vast land masses, including arable land, are important open issues. If the Supreme Court were to review the SEZ Act after it had been in effect since 2006 and determine that part of its provisions violated the Supreme Law, the situation would be ludicrous and would have far-reaching effects. Such a choice could have a negative impact on both the businesses who invested millions of rupees to build infrastructure in the SEZ's processing and non-processing sectors as well as the lives of the poor peasants who lost their main source of income. Justice delayed is justice denied, so the court is expected to act swiftly in order to address the issues of public concern.

#### **V. ANALYSIS**

Many economists are of the view that SEZs can achieve industrial development in efficient and effective way. An investment in SEZs can provide a bundling of public services in a geographically concentrated area as well as improve the efficiency of limited government funds for infrastructure. They also facilitate cluster development of specific industries and improve urban development by providing facilities conducive to improved living conditions for daily wagers and technically skilled workers. Thus, SEZs can be conducive to both job creation and income generation and potentially to protecting the environment and

<sup>953</sup> Farole, T., and G. Akinci, eds. 2011. "Special Economic Zones: Progress, Emerging Challenges, and Future Directions" Washington, DC: World Bank.

<sup>954</sup> WP (C) No. 537 of 2006 order dated 6-8-2014 (SC).

<sup>955</sup> (2010) 7 SCC 129.

encouraging green growth and eco-friendly cities.<sup>956</sup>

Nonetheless, it is important to note that special economic zones should be used to address market failures or binding constraints that cannot be addressed through other options. If the restrictions can be addressed through countrywide reforms, sector-wide incentives or universal approaches then zones might not be necessary.

It may be inferred from a review of the SEZ Act, 2005's provisions and the judgements made in the aforementioned instances regarding their interpretation that the court response to the Act has been mostly supportive of the government's policy.

There are certain essentials that need to be carefully followed in designing and developing an SEZ program to increase the likelihood of success.

#### **A. Choose the Right location**

International experience demonstrates that SEZs frequently thrive in central locations and close to gateway infrastructure. Large-scale, labor-intensive SEZs often benefit from aspects that cities provide, such as access to deep and specialised labour pools, specialised suppliers and business services, social infrastructure, and linkage to local, regional, and international markets. When deciding to establish at least one SEZ in each "lagging" or remote region, some governments (such as the Arab Republic of Egypt, Kazakhstan, and Nigeria) prioritise social equality over economic viability. However, few governments have made sufficient efforts to address the infrastructure connectivity, labour skills, and supply access that the regions typically lack.<sup>957</sup>

#### **B. Promote a conducive business environment with a view to reform**

<sup>956</sup> Lin, Justin Yifu, and Y. Wang. 2014 "China-Africa Cooperation in Structural Transformation: Ideas, Opportunities and Finances" UNU-WIDER Working Paper no. 2014/046.

<sup>957</sup> World Bank. 2019. World Development Report 2020: Trading for Development in the Age of Global Value Chains. Washington, DC: World Bank.

Zones should try to create an atmosphere that is conducive to business and to enhance firm-level competitiveness, innovation, local economic integration, and social and environmental sustainability rather than focusing primarily on fiscal incentives, like tax breaks and free land.<sup>958</sup>

#### **C. Increase market contestability through rigorous market demand**

A zone programme or project needs to be carefully planned, designed, and managed because it is an extremely costly operation. The project also includes the cost of shared services in the zone and the public revenues foregone from the various incentives frequently associated with a zone programme, in addition to the development costs, which include the basic infrastructures, land acquisition and development, and green facilities.

#### **D. Increase the beneficial effects by taking an inclusive and sustainable approach**

Zones must capitalize on their comparative advantages by attempting to include local suppliers in their value chains through an inclusive strategy. The impact of zones would be significantly increased by proactive opportunity identification, effort matching, and training initiatives between businesses inside and outside of zones.<sup>959</sup>

### **VI. SEZ AS A POLICY TOOL FOR ECONOMIC DEVELOPMENT**

It is difficult to quantify the direct effects of special economic zones at the firm level, particularly the effects on domestic businesses. This is partly because there is a dearth of data and partly because it is difficult to locate suitable businesses that can act as "controls" with which to make meaningful comparisons. Even these analyses of the effects of zones on exports, investment, employment, and spillovers

<sup>958</sup> Farole, Thomas, and Gokhan Akinci. 2011. Special Economic Zones: Progress, Emerging Challenges, and Future Directions. Washington, DC: World Bank.

<sup>959</sup> UNCTAD (United Nations Conference on Trade and Development). 2019. World Investment Report 2020: Special Economic Zones. New York and Geneva: UNCTAD.

on businesses outside the zones are rare. The idea of SEZs is gaining more popularity day by day all across the globe. A growing number of nations worldwide are urging the potential offered by zones and striving to take use of their ability to spark structural change and development. SEZs offer a way to create special environments conducive to business in economies where governments otherwise face great difficulties doing so. SEZs are frequently used by governments to boost the value added in export operations or to entice investment in industries without a clear competitive advantage.<sup>960</sup>

The overall image is rather diverse. Across nations and regions, the effects of SEZs on promoting economic and private-sector development appear to be extremely variable, according to disaggregated studies. Successful SEZs are able to draw in a significant number of domestic and foreign businesses, and they also significantly increase corporate investment, employment creation, and economic development.

The basic rationale is that by removing some critical “binding constraints” to economic growth<sup>961</sup>, SEZ policies create incentives for firms and investors that might not otherwise be attracted. These constraints range from regulatory regimes and infrastructure to land and trade logistics. SEZs are able to get over these limitations in a controlled setting and experiment with reforms, new laws, and fresh ideas.

Due to limited resources and implementation capacity, developing countries often cannot create the business environment, or build enabling infrastructure nationwide all at once. In addition, developing countries often have limited political capital to defend policies and reforms against vested interest groups and political opposition. This makes targeted

interventions or a pilot approach necessary, especially at the initial stages. Some newer-generation zones are even becoming the drivers of green development and eco-industrial cities.<sup>962</sup>

The opinions on SEZs in economics literature are highly diverse, in part because SEZ initiatives have had varying degrees of success in various nations or economies. The basic economic model for the establishment of SEZs highlights the possibility of spillovers to the local economy. Case studies have shown spillover effects related to the construction of SEZs. SEZs may also affect the labour markets and welfare of the local economy.<sup>963</sup>

In general, if implemented successfully, SEZs confer two main types of benefits, which in part explain their growth in popularity: “static” or “direct” economic benefits such as employment generation, export growth, government revenues and foreign exchange earnings; and the more “dynamic” or “indirect” economic benefits such as skills upgrading, technology transfer and innovation, economic diversification and productivity enhancement of local firms.

## VII. THE BEST SEZ DEVELOPMENT PRACTICES WORLDWIDE

SEZs are altering over time to accommodate for new business and economic development as the global economic and market conditions change quickly. While the early stage EPZs, now referred to as “Industrial Zones 1.0,” were successful in many countries in the sense that they largely attained their initial objectives of attracting FDI, encouraging exports, and earning foreign exchange, they also have their limitations because they must transform into enclaves, have little connection to the local economy, and rely heavily on fiscal incentives.

<sup>960</sup> Cirera, X and Lakshman, R, 2014. “The impact of export processing zones on employment, wages and labour conditions in developing countries”, *3ie Systematic Review 10*. London: International Initiative for Impact Evaluation (3ie).

<sup>961</sup> Rodrik, Dani. 2004. “Rethinking Growth Policies in the Developing World”, Harvard University.

<sup>962</sup> Zeng, Douglas Zhihua. 2015 “Why Are More Countries embracing Industrial Zones?” (blog), The Trade Post, World Bank, May 5.

<sup>963</sup> Creskoff, S., and P. Walkenhorst. 2009. *Implications of WTO Disciplines for Special Economic Zones in Developing Countries*. Washington: World Bank.

Given these constraints and the shifting macroeconomic and regulatory landscape globally, several nations started to adopt the current definition of SEZs, which have larger sizes, more connections to the local economy, are multifunctional, and rely less on incentives. These SEZs are known as "Zones 2.0." With the increasing concern on the global climate change and environmental stability, a new trend of industrial zones is gaining traction, which is heading toward an even more comprehensive and integrated approach. The "Zones 3.0" concept attempts to develop an integrated approach by combining the Zones 1.0 and 2.0 experiences. The "Zones 3.0" strategy integrates the lessons learned from Zones 1.0 and 2.0 to produce an integrated solution that addresses both domestic institutional frameworks, industries, and communities as well as emerging global trends in low-carbon or green growth.

#### VIII. SEZ POLICIES' APPLICABILITY AND POTENTIAL RISKS IN LOW-INCOME NATIONS

The SEZ policy situation creates a quandary. SEZs' primary goal is to remove many of the severe barriers to economic development that exist in low-income nations like those in Sub-Saharan Africa. Thus, the initiatives provide a major source of hope for these economies. In addition, the risk of launching and maintaining a SEZ programme in these economies is far higher than in middle-income countries due to the same issues in these nations, particularly poor governance, a lack of resources, and weak implementation capacity.

It is crucial to keep in mind that the majority of low-income nations have just recently started adopting modern zone schemes, and many of these zones are still in their infancy. Global value chain and industrial structure modifications and rebalancing may offer these regions fresh chances to develop and prosper.

Overall, the evidence suggests that only a small number of these low-income areas have so far made any appreciable headway in utilizing

economic zones as a tool for long-term structural reform. Among other things, some of the major challenges include:

**A. Challenging legal, regulatory and institutional framework:** In many of these countries the current trend for SEZs is either outdated or do not exist. even after the start of the SEZ programme or, in certain situations, after the parks have started to operate. This strategy has discouraged potential investors and caused a lot of confusion.

**B. Poor business environment:** Costs of doing business are very expensive. The general environment is one of restriction when it comes to registration, licensing, taxes, trade logistics, customs clearance, foreign exchange, and service delivery. Many so-called one-stop shops for investors don't live up to their names.

**C. A lack of strategic planning and a failure to adopt a demand-driven approach:** Effective zone programmes, according to international experience, are a crucial component of a comprehensive national, regional, or municipal development strategy. Successful zones are built on high demand from industry sectors in nations like China, the Republic of Korea, and others. In contrast, many African zone initiatives lack a solid commercial case and are motivated by political ambitions.

**D. Failure to address land acquisition and matters of resettlement:** Governments' commitments to pay compensation in some areas in the event of land acquisition and relocation were either broken or only partially kept. These circumstances impede the zones' continued development.

#### IX. IMPACT ASSESSMENT

The SEZ Act intends to address issues related to or incidental to the construction, development, and management of Special Economic Zones for the promotion of exports.

Sunset Clause for SEZ's tax benefits:



The Finance Act 2016 made it possible to gradually phase out the discounts and exemptions provided by the Act to SEZ developers and SEZ units:

A. No deduction shall be granted to a unit beginning the manufacture, production, or provision of an article or object on or after the first day of April 2020. (Financial year 2020-21 onwards).

B. Section 80IAB states that no deduction is allowed if the stated activity starts on or after April 1st, 2017. (Financial year 2017-18 onwards).

Development of SEZ is permitted under Section 80IAB, and certain offshore banking units' and IFSC units' income is deducted under Section 80LA, among other things.

According to the structure of the relevant provisions of the Act, the Memorandum to Finance Bill 2016 proposed that the provisions with a sunset date not be changed to move the sunset date forward and that for the tax incentive with no terminal date, a sunset date of 31 March 2017 will be provided either for beginning of activity or for claiming benefit.

There is currently no sunset clause on the deduction under Section 80LA of the Act that is accessible to a unit in the IFSC.

## X. CONCLUSION

The number of Special Economic Zones is increasing, and people are starting to accept the idea more widely. The zones are not a cure-all for development, though, as evidence by the inconsistent outcomes in various nations, economies, and regions. Zones must be successfully implemented and carefully adapted to each country's unique circumstances. They are not always an effective tool for development. Given the complex and heterogeneous environments in which zone programs operate, a clear framework is needed to guide the operations of SEZs in countries where they are deemed relevant. Clear duties and responsibilities for the public and

commercial sectors should be part of this structure.

India needs to put an end to corporate land grabs and start concentrating on real human development. India is entitled to economic growth. Rather than fewer individuals owning land in India, the government should ensure that more people do so in order to achieve true progress. Urbanization and a rise in GDP are not what development is about. It entails providing for people's requirements in terms of food, shelter, clothing, access to clean water, and education. In order for India to truly flourish, it must assist its farmers in achieving self-sufficiency.

India's farmers actually have a lot of wealth available to them from their land. Their inability to feed themselves derives not from their line of work but rather from the fact that they must sell all of their crops to pay off debts in order to keep their land.

Key problems are establishing the necessary legal and regulatory frameworks, undertaking needed strategic planning and assessment of business feasibility, frameworks, undertaking needed strategic planning and assessment of business feasibility, finding ways to ensure the provision of adequate infrastructure, and establishing responsible social and environmental standards.

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