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**Effectiveness of SEZs
Over EPZs Structure:
The Performance at
Aggregate Level**

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EFFECTIVENESS OF SEZs OVER EPZs STRUCTURE: THE PERFORMANCE AT AGGREGATE LEVEL

*Malini L Tantri*¹

ABSTRACT

Empirical evidence on the effectiveness of SEZs policy over EPZs structure is analysed in this paper by aggregating data of seven conventional SEZs from 1986-87 to 2007-08. The study reveals that the introduction of SEZs in place of its predecessor, the EPZs, is having a significant and positive impact on its performance at the aggregate level. However, in terms of contribution to national trade, the Indian SEZs are lagging way beyond the expectations of policymakers. Further, the SEZ policy does not seem to be successful in diversifying exports basket, which in turn has affected the direction of exports by SEZs. Moreover, these zones were found to be highly susceptible to external shocks. Thus, we strongly argue in favour of a care in deciding the sectoral choice of SEZs and careful scrutiny of its approval across major Indian States.

Introduction

Free Trade Zones (FTZs)/Export Processing Zones (EPZs) were promoted in India during the "Import Substitution Industrialization (ISI)" period (1964-65). This can be termed as an early attempt to check the possibilities of switching to export promotion strategies, but in a different way. Undoubtedly, the EPZs policy is termed as a successful initiative undertaken during the ISI regime. However, it failed to create the most needed economic space due to lack of a well-structured policy and trade sector controls. During this phase it was noted that the failure was on account of the most-needed incentives structure compared to those available elsewhere (Tandon, 1980) and the poor institutional and infrastructure facilities in these zones (Aggarwal, 2004 and 2005).

The changes in the economic policy during the 1990s altered the trade situation significantly. First, it was the acceptance of opening of the trade and followed by the various measures to promote trade as the major strategy among the growth initiatives (Deepika and Deshpande, 2003). One can see four broad changes in the trade policy in the last two decades. First, the regulations in the trade sector were relaxed across the board and on the most important tradable goods. Second, the procedures were made simple and special care taken to improve participation of different actors. Third, the export sector was incentivized in terms of processes/procedures and fourth, the EPZ policy was reformulated to suit the Special Economic Zones (SEZ) policy. In this context, during late the 1990s, a visit to China by a high-level delegation led by the then Minister of Commerce and Industry, the late Murasoli Maran, changed the course of the EPZ policy in India. Based on their recommendations, the Government of India in its EXIM policy statement of 1997-2002 announced a policy to rejuvenate the EPZs structure

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and to unplug the loopholes to effect the transmutation into the SEZ policy. Thus, SEZs in the present context have their origins traced to the 'qualitative transformation' of the conventional EPZs of the country (Government of India, 2000). The erstwhile EPZs continued to function under the new name and regime defined under the SEZ policy with an added vigor but essentially continuing the same operations. They were also bestowed with leadership in the SEZ family as being the early starters.

The qualitative transformation was engineered by allowing 100 per cent FDI inflow through automatic channels, exemption from daily customs examination of export and import cargo, allowing import on self-certification basis and other measures (Government of India, 2000). Thus, compared to EPZs, the current SEZs policy has more clarity and it is focused not only in terms of objectives but also in terms of institutional arrangements. In this connection, the purpose of this paper is to trace how the changes in the focus of the policy are effective in improving the performance of the SEZs. In particular, we are analyzing here how these SEZs were performing under the EPZs structure and how the interventions through the SEZs policy were successful in promoting trade dynamics. In this context, the earlier studies (Kumar 1987; Kumar, 1989; Kundra, 2000; Aagarwal, 2004 and 2005; Shah, 2009) analysing trade performance of Indian EPZs/SEZs show a few limitations. First, these studies focused largely on EPZs performance in general and did not clearly bring out the role of the EPZs/SEZs in promoting trade. Second, most of these studies are dated and lack rigorous analyses of the effectiveness of SEZs over EPZs. Though Shah (2009) sketches the trade performance up to 2007-08, but did not touch the question of the relative effectiveness of SEZs over EPZs in the country. Given the limitations associated in the existing literature on SEZs, this paper locates the effectiveness of SEZs over EPZs.

The analysis is based on the aggregated data collected from the seven conventional SEZsⁱ, namely, Kandla, Santacruz, Noida, Cochin, Chennai, Falta and Vizagⁱⁱ. Meanwhile, in order to substantiate the secondary findings the author's extended first-hand fieldwork in these seven zones is utilised to validate the findings. The analysis is carried out for the period 1985-86 to 2007-08ⁱⁱⁱ. The time-period under consideration is long enough to analyse the effectiveness of the SEZs policy, enacted in 2000-01, compared to that of the EPZs. The following section provides a brief description of the evolution of FTZs to current SEZs policy in India. This is followed by an analysis of the empirical evidence of the effectiveness of SEZs over EPZs^v in the country, with special reference to trade performance. The last section summarises the paper.

A Brief on Historical Steps Covered from Free Trade Zone to Special Economic Zones in India

India was the first among the developing countries, specifically in Asia, to experiment with the system of 'special enclaves' for promotion of trade in the 1960s. The Kandla SEZ came into existence on the western coast of Gujarat in 1965 as the first FTZ. It came into existence five years after the government took the decision in this regard. Almost a decade later, the Government of India took a decision to set up the first EPZ in Bombay (1974-75), known as the Santacruz EPZ (SEEPZ) for the development of the electronics sector. If we look at the nomenclature alone, Santacruz becomes the first EPZ of the country, and Kandla was the first and only FTZ in the country. Quite erroneously, most of the earlier

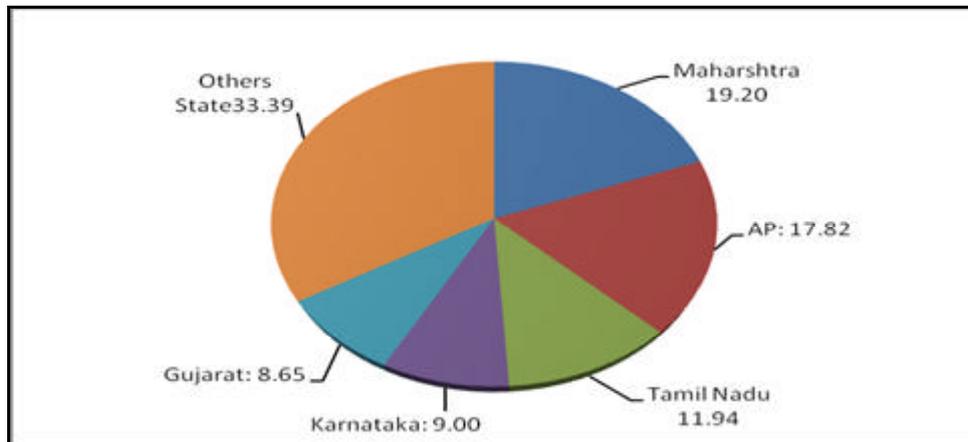
studies on SEZs reported Kandla as the first EPZ of the country. Other than nomenclature, the major difference between the two initial attempts lies in the history and prime objectives of their promotion. The early thought of creating the first FTZ of the country came soon after independence. It was put forwarded to promote the Kandla Port as a substitute to the Karachi Port, which India lost at the time of partition (IIFT, 1990). The Santacruz EPZ on the other hand was proposed by the Trade Development Authority for the promotion of the electronics industry after taking into consideration the growing international demand for the same. In 1986-87, the Government decided to carve out a jewellery sector in the SEEPZ for the export of gems and jewellery. The Kandla and Santacruz zones were followed by a few more based on the recommendations of the Tandon Committee Report (1980), which stressed the importance of such zones in the process of economic growth, specifically to boost the exports of the country. These include, EPZs at Chennai, Cochin, Noida, Falta and Vizag. Except for the Vizag EPZ, which became operational in 1994, all the other zones commenced economic activities in 1985-86. The Central Government owned all these seven EPZs since there was no policy provision for the entry of private sector either through the concerned State Governments or through private investment. Nevertheless, the private investors were encouraged with incentives to establish units in the zones and/or take up joint venture.

In the wake of new economic policy beginning in the early 1990s certain changes in the structure and ownership pattern of these zones were effected. These actually began in 1994 with the Government of India^v allowing State Government and private sector participation in the promotion of EPZs in the country. In this context, the first private EPZ came into existence in 1994 at Sachin Surat exclusively promoted for diamond export. It was followed by a few more interventions to address the structural problems of the transmuted EPZs. Arrora (2003) (Cited in Aggarwal 2004) identified nearly 164 circulars on EPZs/Export Oriented Units (EOUs) issued by the Government of India during early 1990s to bring about the rapid changes. The major shift noticed under the new SEZs policy is mentioned in the EXIM Policy statement of 1997-2002 as a 'qualitative transformation' of the conventional EPZs of the country (Government of India, 2000). It has given a legal framework in 2005, through enacting the SEZs Act, 2005 followed by SEZs Rule, 2006. Besides this, every participating State Governments have enacted State specific SEZs Acts and policies. These State specific SEZs policies helped to locate their orientation along with the State specific requirements. As against the earlier practices under the EPZs regime, the new SEZs policy allows these enclaves to operate as public, private and joint ventures and/or in collaboration with the State Government. The economic activities within these enclaves are encouraged in manufacturing, service and/or trading units, thereby providing for larger areas of operation.

The SEZs policy enacted in the country could be seen as coming in two different phases. Initially, all existing EPZs were converted under the SEZs regime in two different phases. As per the first ordinance the EPZs of Kandla, Santacruz, Cochin and, Surat were initially brought under the SEZs framework in 2000. On the other hand, the EPZs of Noida, Falta, Chennai and Vizag were converted in 2003. This was later followed by fresh approval for different projects under the banner of SEZs. By February 10, 2010, on a very large scale, 578 SEZs were given formal approval and 348 SEZs were notified. The total number of operating SEZs in the country now stands at 105 (www.sez.nic.in).

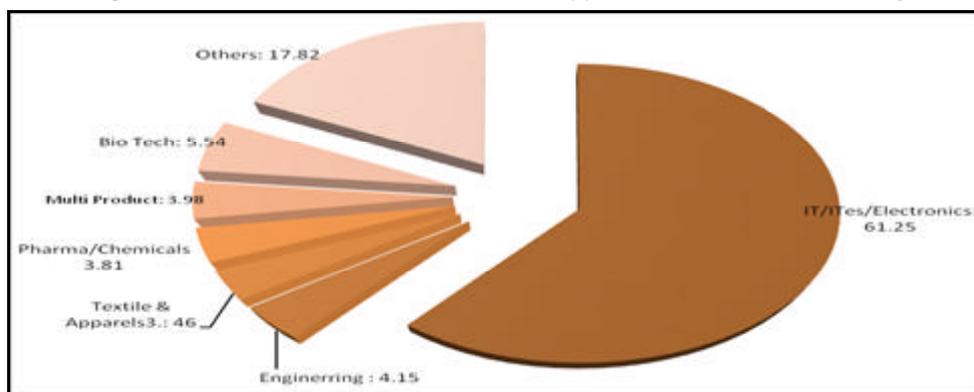
However, the State and sector wise distribution of formal approval^{vi} of SEZs presents a few glaring inequities. State wise, the developed States like Maharashtra, Andhra Pradesh, Tamil Nadu and Karnataka received more number of approvals. The share of the other States is just 33.39 per cent of the total SEZs approved in the country (Figure 1a). Within the developed States, the SEZs are located in a few districts, which are above the national average in number of development parameters (Mukhopadhyay, 2009). This in turn is assumed to have adverse an impact on urban planning due to congestion and diseconomies of scale (Mitra, 2007); specifically, these zones may ruin the existing infrastructure without actually adding to the infrastructure base in the country (Mukhopadhyay and Pradhan, 2009). Thus, if proper attention is not paid it may aggravate the problem of regional disparity in India. Sector wise, on the other hand, IT/ITes/electronics industries received maximum approval in the country (Figure 1b). This pattern, further, comes in conflict with the argument put forth in the promotion of these enclaves as efforts to develop a strong industrial base in the country and mitigate the problems of unemployment.

Figure 1a: State wise Distribution of SEZs Approval (Formal) in the country



Source: www.sez.nic.in

Figure 1b: Sector wise Distribution of SEZs Approval (Formal) in the country



Source: www.sez.nic.in

Performance at the Aggregate Level

Trends in Trade through SEZs

The basic purpose of the SEZs policy is to enhance production of exportable commodities in an environment free of the usual constraints of the domestic industry. Therefore, trends in EPZs/SEZs trade can be seen as a proxy for analysing the effectiveness of the policy and this has been explained in this section. The EPZ/SEZ existed since 1960s and hence it will not be erroneous to look into the trends from 1985-86 to 2007-08. The focus of the exercise is to assess how these enclaves were performing initially under EPZs policy and were there any significant breaks in the trends especially after 2000, following introduction of the SEZs policy.

Table 1 presents the time series data on SEZs exports and imports (expressed in Rs crore at Constant Prices) for the period between 1986-87 and 2007-08 (reference period of the study).

Table 1: Trade Scenario of EPZs/SEZs (for major few years from 1986-87 to 2007-08)

(Values are in Rs Crore and at Constant prices)

Year	Total SEZs Export		Total SEZs import		NFE	
	Value	Growth rate (Per cent)	Value	Growth rate (Per cent)	Value	Growth rate
1986-87	975.96		624.3874		351.57	
1990-91	1822.54	17.02	1181.621	13.13	640.92	24.93
1995-96	3896.51	14.91	2641.943	33.28	1254.56	-10.94
1999-00	6716.23	23.53	3032.003	37.29	3684.22	14.11
2000-01	10053.62	49.69	3583.341	18.18	6470.28	75.62
2001-02	8009.60	-20.33	4456.741	24.37	3552.86	-45.09
2002-03	8323.65	3.92	5183.047	16.30	3140.61	-11.60
2003-04	9781.32	17.51	5968.612	15.16	3812.71	21.40
2004-05	12575.74	28.57	8983.272	50.51	3592.47	-5.78
2005-06	15428.38	22.68	9667.567	7.62	5760.82	60.36
2006-07	17508.71	13.48	11670.85	20.72	5837.86	1.34
2007-08	21195.77	21.06	15832.97	35.66	5362.80	-8.14
Trend Growth Rate (CAGR)						
1986-87 to 2007-08	16.90		18.30			

Source: Based on the data collected from the Seven Conventional SEZs Development Commissioner Office

Note: Growth rate is the percent changes over the preceding year

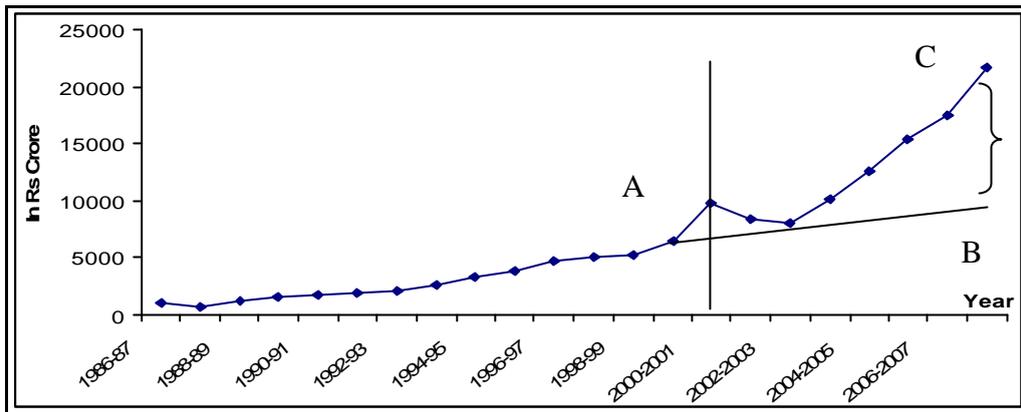
Altogether, one can note two major breaks in the trends in EPZs/SEZs trade performances during these years. The first break in trend is noticeable in the early 1990s^{vii}. This positive development in trade performance could be attributed to two major policy developments. First, there was improvement in the general economic scenario of the country, in the post-reform period, particularly, the reduced tariff rate, relaxation in quantitative restrictions on exports and imports and the measures

undertaken to rationalize the exchange rate. The second is related to specific policy initiatives undertaken to carry out reforms in the EPZs framework and the most important among them includes permission for DTA sale up to 25 per cent of production on payment of 50 per cent custom duties and allowing the role of the State and private sectors in the EPZs structure of the country. It implies that though these zones are considered as exclusively separate economic entities the general macroeconomic framework and corresponding business climate of the country vastly influences the outcome of these zones along with specific policy initiatives addressed to SEZs. This in turn also explains implicitly the factors responsible for the poor performance of EPZs up to 1990s.

The second, break is noticed in 2000-01 following the introduction of the SEZs policy in the country. Within eight years of introducing the SEZs policy in the country, the value of exports generated from seven conventional SEZs of the country increased almost three-fold. In 1999-2000, the value of SEZs exports was around Rs 6 crore in and in at the end of 2007-08, it was Rs 21,000 crore. Except for 2001-02, SEZs exports have shown positive trends but with greater volatility (Table 1). A setback in the value of exports and its growth rate noticed in 2001-02 could be due to the switchover of couple of units from EPZs framework to EOUs rather than accept SEZs scheme^{viii}. In the Vizag SEZ, for instance, units like Synergies (an exporting unit), which were dominating the trade scenario preferred to shift their economic base from EPZs activities to EOUs. This had a corresponding impact on the trade performance of the Vizag SEZ^x. On the eve of the withdrawal of Synergies, the export value of the Vizag SEZ fell from Rs 1,956 crore in 2002-03 to Rs 534 crore in 2003-04. Further, between 2000 and 2003, a decline in the number of exporting units in most of the seven conventional SEZs was noticed. For instances in the case of the Kandla and Santacruz SEZs, the number of exporting units dropped, respectively, from 129 to 109 and 150 to 103 between 1999-2000 and 2000-01^x, though it increased in the subsequent year.

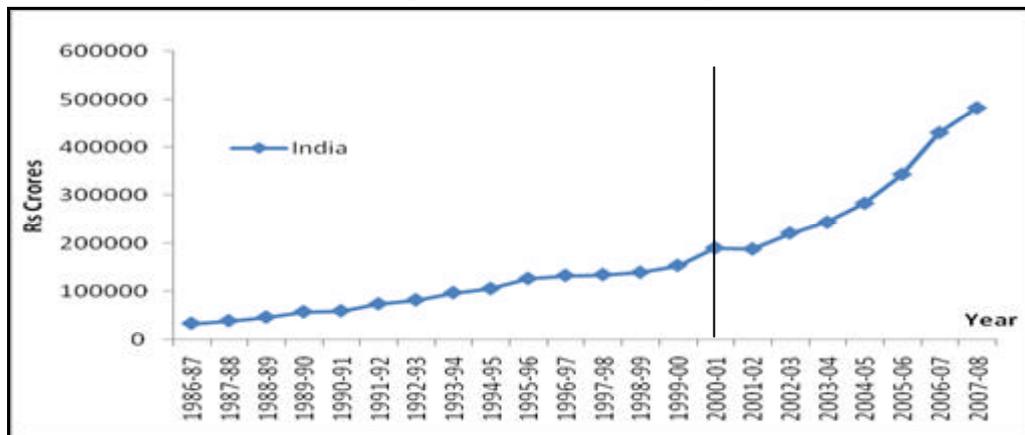
It is very interesting to note that in line with the break in SEZs exports in 2000-01 a similar pattern could be seen with respect to India's exports trend (Figure 2.1a and 2.1b). There was an increase in the exports value for one year (2000-01) and a dip in the next financial year - similar to the case of SEZs exports. This reveals the growing dependence of India's exports on SEZs exports and henceforth indicates the need to re-engineer the SEZs structures in the country. The value of imports of the SEZs, on the other hand, displayed more or less similar patterns of growth in the reference period. However, it should be noted that, despite an increase in the gross value of exports there was not much increase in the net foreign exchange earnings from these enclaves. In fact, the net foreign exchange earnings from these enclaves for 2007-08 are less than that of 2000-01. Even in the context of other Asian EPZs/SEZs, a similar pattern of higher gross exports but failure to reflect the same in NFE is found (Amirahamdi and Wu, 1995). Moreover, in the current SEZs regime there are variations in growth rates of net foreign exchange earnings compared to the same figure during EPZs regime.

Figure 2a: Trend in SEZs Exports



Source: Based on the data collected from Seven Conventional SEZs Development Commissioner Office

Figure 2b: Trend in India's Exports



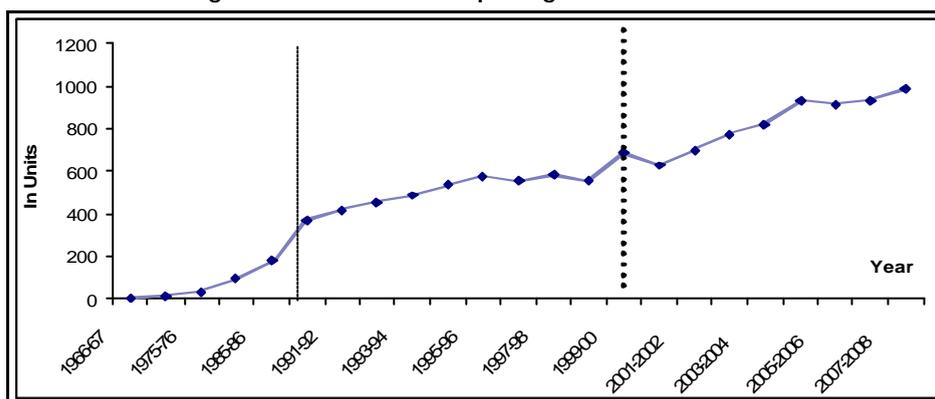
Source: Computed from data collected from RBI Annual report, 2007-08

At the aggregate level, exports earnings from these zones recorded a steady increase during the period under analysis. This expansion in exports, among others,^{xi} could be due to the increase in the number of zones and corresponding increase in the number of exporting units in each zone or improvement in productivity. As one can see in Figure 3, over the years the number of exporting units in the seven SEZs increased from one in 1964-65 to 985 by the end of 2007-08. In this regard a few interesting observations emerge. One, there was a steady increase in the entry and operation of exporting units in EPZs after the commencement of the Santacruz EPZ in 1975 and others in 1986-87. Corresponding to this, there noted a steady increase in their growth rates (Figure 4). This indicates the positive response of investors to the new policy of the Government. Two, a few units, especially in Kandla and Falta, closed down in the early 1990s due to the disintegration of the USSR which was a major trade partner for these zones.

Further, the East Asian crisis of the late 1990s also had an impact on the performance of the Kandla, Chennai and Cochin SEZs both in terms of value of exports and number of exporting units. This leads us to support the argument of Wong and Chu, that "... EPZs are vulnerable to changing conditions in the world economy, such as recessions and inflation, which may bring about extensive

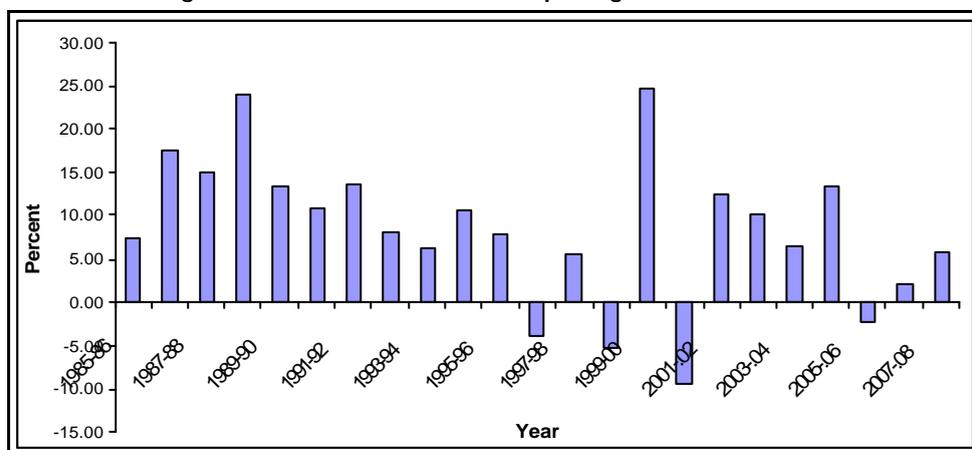
closures and lay-off" (1985; p 20-21). However, we have seen that the exposure to such vulnerable conditions depends on the type and intensity of association of these enclaves with the world economy. If investments in such enclaves are largely dominated by foreign investments and in a particular sector, then it will not only result in a sudden drop in investments but also a decline in the value of the exports and a fall in employment generated in these enclavesⁱⁱ. Thus, these enclaves may act as agents to percolate the global chain of recession and/or inflation into the different sectors of the domestic economy. The capacity to cope with such vulnerable conditions, depends upon, among others things, on the diversity of the SEZs export baskets and their trading partners. For instance, the disintegration of the USSR in the early 1990s hardly had any negative impact with respect to performance of the Santacruz, Noida and Chennai zones due to their sectoral composition, which was also helpful in shaping their trading partners. Thus, along with the promotion of such enclaves it is also equally important to diversify their export baskets and trading partners. Three, as outlined above, the negative growth rates observed in the exporting units in 2000-01 were due to the switch over of a few units from the EPZs scheme to the EOUs. Despite the steady increase in exporting units over the last eight years, these zones are not occupied to full potential given their total size as argued by Aggrawal (2004).

Figure 3: Trend in Total-Exporting Units in EPZs/SEZs



Source: Based on the data collected from Seven Conventional SEZs Development Commissioner Office

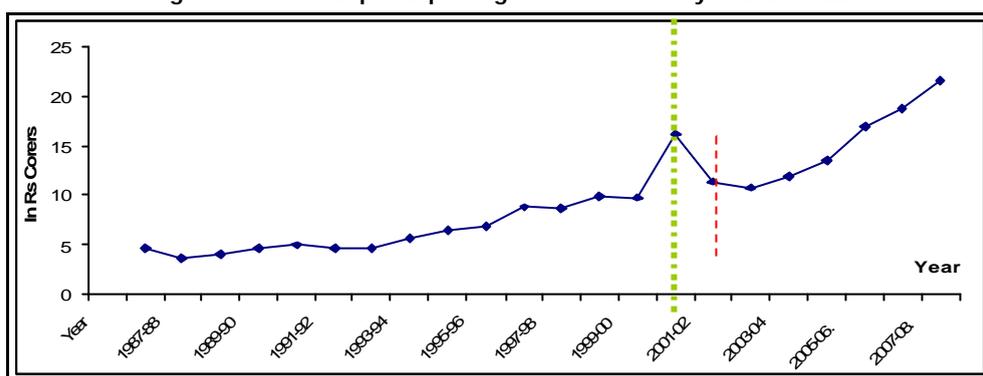
Figure 4: Annual Growth Rate of Exporting Units in EPZs/SEZs



Source: Based on the data collected from Seven Conventional SEZs Development Commissioner Office

In line with the increase in the number of exporting units, it would be quite interesting to see corresponding changes in productivity. This is referred to as average unit productivity of SEZs and is analysed here (Figure 5). It is good to observe positive and steady increase in the productivity. Up to the 1990s per unit exports, was around Rs 2 crore. It was in the post liberalisation period, especially post-SEZs regime, that a steady increase from single digit to double digits was recorded. In 2007-08, exports worth Rs 21.52 crore were generated from each exporting unit. This implies that exporting units turned to be more competitive and productive particularly after the implementation of SEZs policy.

Figure 5: Trends in per Exporting Units Productivity of EPZs/SEZs



Source: Computed from data collected from the Offices of the Development Commissioner
Note: Values are in Rs crores at Constant Prices

The Performance in the Current SEZs Period (2000 onwards)

We now turn towards the question, whether there is any break in terms of the performance of the SEZs after 2000-01, the period that witnessed introduction of the new SEZs policy to replace the EPZs structure of the country. It is clear from the graph 1 that there was a structural break in 2000-01 (Figure 1a). In the absence of any policy changes one could have expected growth in the exports of the SEZs to the tune of AB, whereas due to policy interventions SEZs exports grew at the rate of AC. A similar pattern can be traced in the case of exports generated per exporting unit (Figure 4). To substantiate the results (obtained through graphical representation), we carried out the structural stability (Dummy) regression model^{kiii}. The Functional Form of the Structural Stability Regression is as follows:

$$Y = a_1 + a_2 D_1 + b_1 t_1 + b_2 (Dt) + u_t \quad \dots\dots\dots (1)$$

In this,

- Y = Exports;
- D = Dummy variable. It takes value 0 for EPZs period (1986-87 to 1999-2000) and one during SEZs period (20001-01 to 2007-08)
- T = Time period

In this model, whether the introduction of SEZs policy in the place of its predecessors namely, EPZs, has any significant impact on the performance is explained based on the significance of the coefficients of the dummy intercept and slope coefficients. If both are statistically significant then it

implies that the SEZs policy intervention has had a statistically significant impact on performance. On the other hand, null hypothesis of there is no impacts of policy changes on the performance of SEZs tend to accepted if dummy intercept reveals statistically insignificant value. Results presented in Table 2 clearly demonstrate break in terms of trade performances since the intercept and slope dummy coefficients are found statistically significant at 1 per cent. This substantiates the strong impact of policy changes on the overall working of SEZs in the country. However, it should be noted that the coefficients of the dummy intercept though found statistically significant but it has revealed a negative sign. This needs to be interpreted very carefully. Since slope coefficient has revealed signs of significant and positive impact, the negative sign of dummy intercept does not imply that the introduction of the SEZs policy has a negative impact on performance. Rather, as outlined above this could be due to the fall in the number of exporting units and the corresponding fall in the exports between 2000-01 and 2001-02.

Table 2: Results of Regression

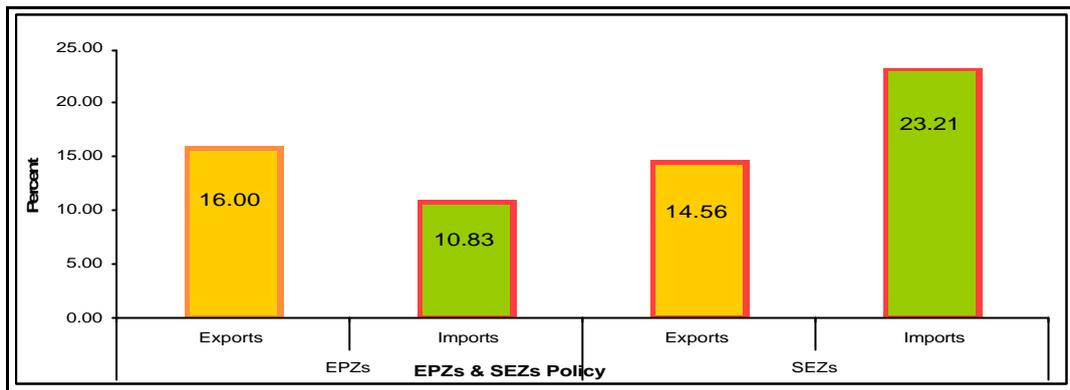
Dependent Variable: Exports
N: 22; K: 4; R²: 0.94; Df: 18

Coefficients	Coefficient Value	t Value
Constant	-210.71	-.297
Time	433.94	5.201*
Dummy	-19877.13	-5.388*
Time*Dummy	1347.003	6.373*

Note: * significant at 1 percent level

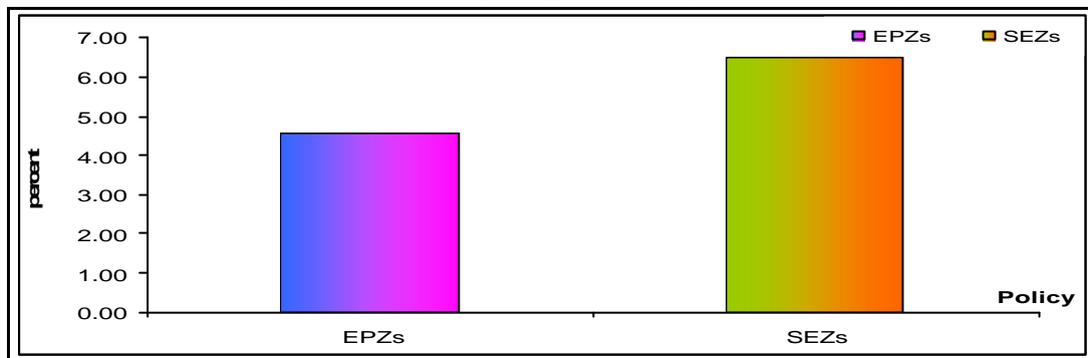
While comparing the trend in the growth rate (CAGR) of exports and imports between two time periods - 1992-93 to 1999-2000 (pre SEZ period/EPZs period) and 2000-01 to 2007-08 (current SEZs period) - it is noted that the growth rate of SEZs imports has increased sharply from 10.83 per cent to 23.21 per cent between the two time periods. Contrary to this, there was a decline in the growth rate of exports, from 16.00 per cent to 14.56 per cent (Figure 6). Thus, an increase in the absolute value of exports during the current SEZs period in comparison with EPZs regime, could not be substantiated with the trend growth rate for the same (CAGR). Moreover, on an average, SEZs imports have grown faster than SEZs exports. During the period between 1985-86 and 2007-08, the average growth rate of imports was 18.30 per cent, 1.40 percentage higher than that of SEZs exports (Table 1). Despite the over-riding value of imports, the SEZs exhibited a positive trade balance during the period under analysis. The higher growth of imports over exports during the current SEZs period is due to the increase in the entry of new units under the SEZs regime. This is evident even in the CAGR of Units, which is higher during current SEZs period compared to EPZs regime (Figure 7).

Figure 6: Compound Annual Growth Rate of EPZs & SEZs Trade



Source: Based on data collected from the seven Conventional SEZs Offices of the Development Commissioner

Figure 7: CAGR of Exporting Units during EPZs and SEZs Regime



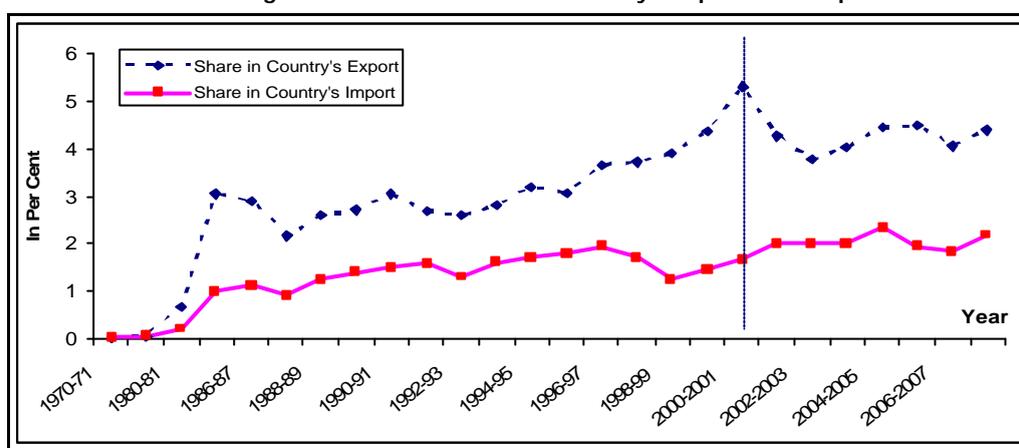
Source: Based on data collected from the seven Conventional SEZs Offices of the Development Commissioner

Trade Participation of SEZs

Based on the above facts, one cannot gather only pessimistic views about Indian SEZs. Moreover, absolute comparison may not be the right approach for understanding the export intensity of SEZs. The dynamics of SEZs can be captured only through its status in the country's trade scenario. This, in the present context is analysed by measuring the EPZs/SEZs share in the country's total trade. The contribution of EPZs/SEZs to the country's exports and imports, presented in Figure 8, shows a positive increase over the years. During the 1970s, the contribution of the SEZs in the exports and imports of the country was, respectively, 0.02 and 0.03 per cent. In the last 25 years, the SEZs share in country's exports and imports has shown a gradual increase with a few major breaks in trend. One can notice that between 1980-81 and 1985-86 the EPZs share in country's exports and imports picked up very sharply from 0.67 and 0.22 to 3.05 and 1.02 respectively. This sudden rise in EPZs share in India's trade is due to emergence of gems and jewellery sector in the Santacruz EPZ. On the other hand in the current SEZs period (after 2000), there was a decrease in the contribution of the SEZs for two consecutive time-spans (from 2000-01 to 2002-03) because as per the Government's new ordinance, all working EPZs were converted into SEZs at two different stages. Consequently, a couple of units, which were willing to concentrate on the domestic market, switched their economic base from EPZs to EOUs rather than get into the SEZ regime. Focusing attention on the period from 2000-01 to 2007-08, during

which the EPZs policy was substantially liberalised with the imposition of the SEZs framework, an upward trend was noticed in the relative share of the SEZs in exports and imports after an initial two-year fall in the same. However, the value of the exports of all working SEZs in India for 2007-08 accounts for about 10 per cent of country's total exports, which is a highly appreciable development^{xiv}. However, if we compare the contribution of such enclaves in other countries it is noted that Indian SEZs are way below in performance. For example, the Shenzhen SEZ alone contributed 14 per cent of China's total trade for 2005-06 (CSY, 2006 and SZSY 2006). Within Asian zones, the Indian SEZs are not comparable with those of Bangladesh and Sri Lanka (Aggrawal, 2005) thereby emphasizing a larger scope for further expansion in its performance.

Figure 8: EPZs/SEZs Share in Country's Exports and Imports



Source: Based on data collected from the Offices of the Development Commissioner and RBI Annual Report 2007-08

Note: Values are in percent

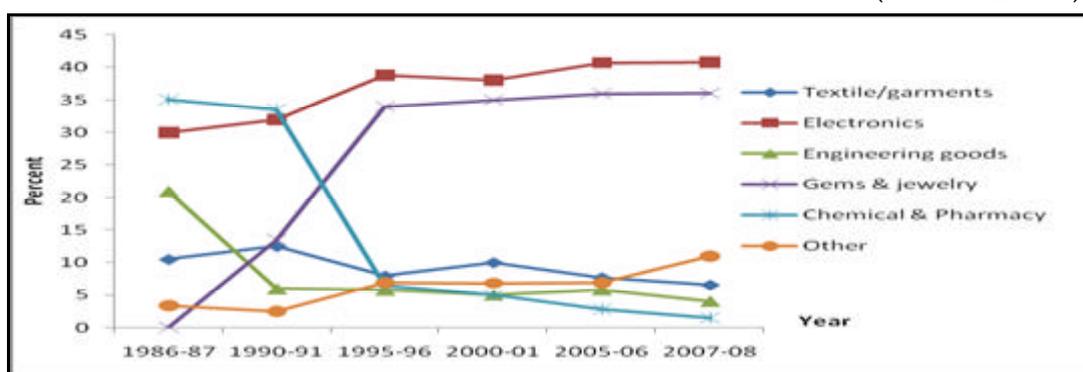
Structure of SEZs Exports

Having analysed the trends in exports and imports it would be quite interesting to trace the changes in the composition of the SEZs trade. It is especially important because the major concern of the trade policy is not only associated with higher exports earnings but also in diversifying the commodity and sectoral composition of exports, particularly towards high value exports. Theoretical arguments in favour of diversification of exports originate from two different views. The first theoretical justification dates back to the 1950s in line with the thesis put forwarded by Nurkse (1953) and Prebisch (1959). Nurkse sketches the poor performance of the LDC as due to the composition of their exports, which is primarily inelastic in demand. Prebisch, on the other hand, illustrated its consequences in terms of the deteriorating terms of trade. Convinced by the theoretical arguments and empirical evidence, most of the developing countries in the 1960s and 1970s changed trade policies to diversifying their exports. The second theoretical justification in favour of diversification of exports was based on the argument of a possible correlation between instability and diversification of exports. Instability of exports in most of LDCs is put forward as a consequence of higher sectoral and geographical concentration which eventually was assumed to affect the overall growth of the country in question^{xv}.

In this context, it is to be noted that Indian EPZs, specifically the Santacruz EPZ, was initiated for diversifying India's exports, specifically in electronic products. This was later followed by promoting gems and jewellery in the Santacruz EPZ. Moreover, one of the stated objectives of the current SEZs policy is to diversify India's trade. Thus, the effectiveness of EPZs/SEZs in diversifying exports as well as the changes over the years is analysed in this section. This is explained by presenting the structure of SEZs exports^{xvi} under broad sector divisions for a number of years between 1986-87 and 2007-08.

Figure 9: Structure of SEZs Exports, by Broad Sector Divisions

(1986-87 to 2007-08)



Source: Based on Data collected from the seven Conventional SEZs Offices of the Development Commissioner

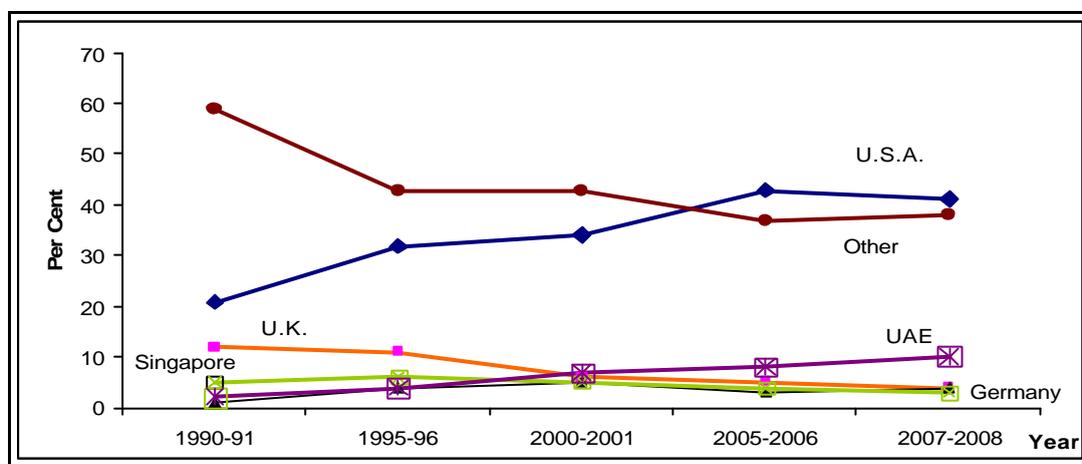
From figure 9, it is evident that until the mid-Eighties, chemicals and pharmacy followed by electronics goods had the highest share in the total trade of the country. They accounted for almost 66 per cent of the total exports of SEZs for 1985-86. This is followed by engineering and textile garments. The early 1990s witnessed changes in the composition of exports largely due to emergence of gems and jewellery units in Santacruz EPZ in the late 1980s. Since then gems and jewellery units, followed by electronics industries, have been dominating the composition of exports in these special enclaves. Currently gems, jewellery and electronics together contribute almost 77 per cent of the total conventional exports of SEZs of the country. The maximum share generated by the Santacruz SEZ, which is exclusively allowed to promote these two sectors. Despite having multi-product base, the SEZs are, disappointingly, influenced by the two sectors namely gems and jewellery and electronics. This could also be one of the factors for the poor performance of Indian SEZs in comparison with their counterpart somewhere else.

The changes over the years in the direction of trade reveals whether the country's trade is concentrated in only a few countries or has to diversify in terms of its reach to different markets. To understand this direction we have presented SEZs exports to a few major countries^{xvii}. As can be seen in Figure 10, over the years USA has emerged as one of the prominent trade partners of the SEZs in India. This is especially due to changing sectoral composition of SEZs exports, which is dominated by the gems, jewellery and electronics, which is concentrated in USA. The share of other countries, on the other hand, has reduced gradually from 59 per cent in 1990-91 to 38 per cent in 2007-08. The reason for the concentration of SEZs exports on a few markets is due to the sectoral composition, which is restricted to few products. Thus, contrary to the argument of Aggarwal (2004), which relate changes in

the sectoral composition to changes in the trading partner of SEZs, our findings suggest that over the years, changes in the direction of exports have been in line with the changes in the sectoral composition of SEZs exports. This is because, as per present understanding of comparative advantage, a country tends to enter into international trade based upon its comparative advantage and factor endowments; whereas the availability of international market alone does not determine the composition of exports, which is quite difficult at least in the short run. Thus, unless the government take steps to diversify its exports it would be quite difficult to diversify its reach in the international market. Further, it is seen that due to a common sectoral composition of these enclaves, zones tend to compete with each other in the same international market.

Figure 10: Direction of EPZs/SEZs Exports

(1986-87 to 2007-08)



Source: Based on Data collected from the seven Conventional SEZs Offices of the Development Commissioner

Summary

In this paper, the empirical evidence to analyse the effectiveness of the SEZs policy over the EPZs structure of the country is put together. It is observed that the introduction of the SEZs policy has had a positive and significant impact on the working structure of these enclaves. The performance of the SEZs in terms of their share in the country's trade presents an optimistic picture but still is not comparable to the SEZs in other countries. An analysis of the trend of India's exports, vis-à-vis with SEZs exports, reveals that changes enacted in the SEZs policy left its imprints on the total value of exports. This underlines the growing dependence of India's export on the growth and performance of SEZs. At the same, it is noticed that the general macroeconomic structure and business environment of the economy significantly shapes the overall working of these zones. Thus, it establishes the bidirectional relation between SEZs and rest of the economic scenario.

Moreover, these enclaves were noted to be highly sensitive to any changes in the global economy in terms of global slowdown or inflation. The capacity to withstand against it depends on how well the SEZs are diversified in terms of products and trading partners. Thus, along with building up of trade-related infrastructure in the context of SEZs, it is equally important to diversify the exports of

these enclaves, which may require more elaborate macroeconomic policy support. However, the SEZs policy in the present context has not been very successful so far in diversifying exports. This has a strong policy implication as aptly remarked by Kundra: 'instead of establishing multi-product SEZs, the State should promote two or three product-based SEZs' (2000, pp-74) from both efficiency and cost point of view. Thus, instead of directing and assessing these SEZs on policy objectives, their development and performance should be guided by the existing comparative advantages (Wong 1987). The most important task to be undertaken, in this regard, is to identify each region's comparative advantage in factor endowment and production. Theoretically, also, the exports to be promoted from a region and/or an attempt to attract foreign investments should reflect the factor endowment or else it may result in under utilization of resources due to non-availability of the required factors at reasonable costs and other supporting mechanism. Moreover, unless the Government takes serious steps to diversify its exports, it would be difficult to diversify its reach in the international market as well. This will make these enclaves more susceptible to changes in the world economy through either recession and/or inflation. A scrutiny of the newly approved SEZs in the country further mirrors the mal-adjustment not only in terms of sectoral composition but also in terms of SEZs approval across the States. It is clear that the developed States have received maximum approval and backward States are lagging even in attracting the attention of investors. This, thereby, indicates the problem of regional disparity, which may aggravate in future if adequate remedial measures are not initiated. Moreover, we know a little about the performance of these enclaves at the disaggregated level and way to boost the performance of poor performing zones. We sum up without any further addition that there is a need to restructure the SEZs scheme in the country, specifically by identifying the problems and prospects in expansion rather than just extending liberal incentive schemes.

End Notes

- ⁱ Currently operating SEZs in the country could be categorized under two major types, viz., Conventional SEZs and Modern/new SEZs. Conventional SEZs are those which were operating under the EPZs structure of the country, and currently brought under the SEZs scheme. Modern SEZs, on the other hand are those which got approval after the enactment of SEZs policy in the country.
 - ⁱⁱ The zones were set up respectively in 1964-65 (KSEZ), 1974-75 (SSEZ), 1986-87 (CSEZ, MSEZ, NSEZ, FSEZ) and 1989-90 (VSEZ)
 - ⁱⁱⁱ Though the present analysis is restricted to the period from 1986-87 to 2007-08, but wherever necessary, we have provided the scenario as it existed in the 1970s and 1980s.
 - ^{iv} In the present analysis, EPZs and SEZs are used synonymously
 - ^v Under Indian Constitution, trade is on Central List
 - ^{vi} The SEZs approval in the country could be categorized under two heads, namely, in-principle and formal SEZs. The classification is based upon the stage of approval of the SEZs. In the case of in-principle approval, the developer gets approval considering the plan of the SEZs projects. Formal approval, on the other hand, is the final approval for SEZs projects from the BoA
 - ^{vii} In addition to this, the late 1980s has also seen improvement in exports by these enclaves the number of zones operating in the country increased from two to six.
- Besides this, the early 1970s also witnessed changes in the trend of SEZs exports. This break in trend was in analogous with the India's exports. At this particular juncture, the country's exports (in value terms) more than doubled due to depreciation of the Indian currency. As Nayyar (1970) noted, there was 21 per cent increase in the rupee value of India's exports in the first half of the 1970s.

- viii Since the former allows 50 per cent sale of production in the domestic market without any additional tax. Such sale under the SEZs scheme, however, requires payment of custom duties because the SEZs policy does not allow sale in the domestic market.
- ix The Vizag EPZ was brought under the SEZs framework in 2003 along with Noida, Falta and Chennai EPZs
- x Kandla, Santacruz, Cochin and Surat were brought under the SEZ purview in 2000.
- xi As explained already exports earning revealed better performance in line with improvements in the general macroeconomic scenario of the country in general and the policy addressed these zones in particular.
- xii Historically such scenario is revealed in the case of Philippines, Bhutan, Taiwan and Chinese enclaves.
- xiii Chow test is not feasible in the present set of analysis due to less number of observations, which eventually provides less degree of freedom.
- xiv Generated from all working SEZs in the country
- xv Among others see discussion by Masell (1970), Kingston (1973), Kingston (1976)
- xvi There are a lot data-specific problems involved with respect to Indian SEZs. One is non-availability of data on sectoral composition of imports of any of the seven conventional SEZs. Thus, we are analysing sectoral composition of exports without sketching the sectoral composition of imports.
- xvii Due to data constraints we could not present the trade scenario of SEZs with any other major countries and regions.

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