Reforming India's Special Economic Zone (SEZ) Policy Amid US Tariff Pressures

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Special Economic Zone (SEZ) Latest News

- **A government panel** comprising officials from the Commerce and Industry Ministry, NITI Aayog, and exporters is **formulating new Special Economic Zone (SEZ) norms** to revive manufacturing and support exporters adversely affected by steep US tariffs.
- The move **comes amid rising requests for de-notification of SEZ units** and demands for a **reverse job work policy** to enable better domestic market integration.

SEZs in India

- **Meaning**: SEZs in India are **geographically delineated, duty-free enclaves** that are **treated as foreign territory** for the purposes of **trade operations, duties, and tariffs**.
- **Objectives**: They are **industrial areas designed to promote exports**, attract domestic and foreign investment, generate employment, and develop robust infrastructure by offering a more **stable and**

business-friendly regulatory environment with a variety of incentives.

- **History**:
  - 1965 – India's first Export Processing Zone (EPZ) was set up in Kandla, Gujarat.
  - 2000 – India introduced **SEZ policy** to increase exports and attract **Foreign Direct Investment (FDI)**.
  - 2005 – The **SEZ Act** was passed, formalising SEZ regulation in India.
  - 2006 – SEZ rules were notified, leading to rapid growth in SEZ approvals.
- **Administration:** SEZs are managed through a three-tier structure –
  - The Board of Approval (BoA) for approving SEZ establishments,
  - The Unit Approval Committee (UAC) at the zone level for unit approvals, and
  - The Development Commissioner (DC) who oversees daily operations.
- **Operations**:
  - Operational flexibility is provided through aspects like allowing **100% FDI** in most sectors via the automatic route and the requirement for units to be a "**Net Foreign Exchange Earner**" over a five-year period.
  - India currently has **nearly 276 operational SEZs across different states**, focusing on a wide array of industries including IT, pharmaceuticals, and engineering.

SEZs and Their Challenges

- **Export performance**: India's SEZ exports in FY25 stood at $172 billion from nearly 276 units, with **only 2% of production** catering to the domestic market.
- **Comparative lag**: Indian SEZs have underperformed compared to **China's SEZ model**, which transformed its industrial base through large-scale manufacturing, logistics integration, and export-led growth.
- **Current crisis**: Several SEZ units catering primarily to the US market face **reduced competitiveness** due to tariff hikes, leading to production losses and job risks.

Key Policy Demand – Reverse Job Work

- **What is reverse job work?** A proposed policy allowing SEZ units to perform production or processing work for the domestic tariff area (DTA) instead of exclusively for exports.

- **Rationale behind the demand:**

  - **Optimal utilisation**: SEZ units face seasonal export demand, resulting in underused labour and equipment capacity.
  - **Efficiency boost**: Integration with the domestic market could enhance productivity and resource utilisation.
  - **Fair competition**: The challenge lies in ensuring parity in duty exemptions between SEZ and domestic units so that domestic producers are not disadvantaged.

Sectoral Focus – Gems and Jewellery Industry

- **Dominant share**: Nearly 65% of India's studded jewellery exports originate from SEZ units.

- **Tariff impact**: The US, being the largest destination, has severely affected this sector.
- **Industry demands:**
  - Allow reverse job work and DTA sales.
  - Extend export obligation periods.
  - Grant interest moratorium on packing credit and working capital loans.
  - Keep factories and artisans engaged and safeguard employment.
- **Trade imbalance concern**: Rising imports of raw materials and marginal growth in exports are leading to a negative trade balance within SEZs.

Structural Challenges in SEZs

- **Declining unit numbers:** *For example,* before 2019 there were 500 gems and jewellery units, which reduced to around 360 units in 2021-22, reflecting policy uncertainty and reduced fiscal incentives.
- **Low R&D investment:** Only 4 of 14 surveyed SEZ units invested in R&D, revealing **minimal innovation focus**.
- **Skill and technology gaps**: Lack of modern training, inadequate funds, and poor quality of upskilling programmes.
- **Weak FDI:**
  - FDI inflows remain low due to –
    - Absence of investment protection agreements (unlike Vietnam).
    - Negative perception of Indian SEZs.
    - Weak brand promotion and marketing efforts.
  - FDI is crucial for technology transfer, brand building, and global networking.

Institutional and Policy Response

- Instead of waiting for a comprehensive SEZ Bill, the government is considering f**aster administrative measures.**
- However, the Finance Ministry’s reservations on **potential revenue loss** have delayed immediate implementation.
- The ICRIER has recommended **a review of trade balance mechanisms** after the **removal of the Net Foreign Exchange (NFE) earnings criteria**.

Way Forward

- **Adopt reverse job work policy**: Allow limited DTA access under transparent norms ensuring fairness with domestic manufacturers.
- **Promote R&D and skill development**: Establish dedicated innovation funds and training centres within SEZs.
- **Enhance FDI attractiveness**: Introduce investment protection agreements and marketing initiatives to improve SEZ image.

- **Streamline SEZ governance**: Simplify compliance and integrate SEZs within the logistics and industrial corridors.
- **Sectoral support measures**: Particularly for gems and jewellery, offer credit relief, export extensions, and infrastructure upgrades.

Conclusion

- India's SEZ policy is **at a crossroads**. While global trade disruptions and US tariffs have exposed **structural weaknesses**, they also present an **opportunity** to restructure SEZs for long-term competitiveness.
- It is essential to **revitalise SEZs as engines of export-led industrial growth**, ensuring both resilience and job preservation in key manufacturing sectors.

Source: IE
