

Economic Growth and Social Cohesion in a Federal Polity:
Special Economic Zones in India

Dissertation submitted to Jawaharlal Nehru University in partial fulfillment of the requirements for the award of the Degree of

Master of Philosophy

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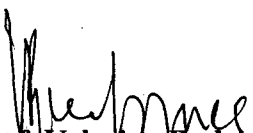
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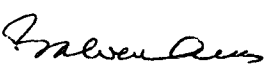
CERTIFICATE

I hereby, declare that the dissertation entitled, '**Economic Growth and Social Cohesion in a Federal Polity: Special Economic Zones in India**' submitted by Shubha Rani Gargava, Centre for Political Studies, School of Social Sciences, Jawaharlal Nehru University, New Delhi, is in partial fulfillment of the requirements for the award of the degree of Master of Philosophy of this University. This Dissertation is original and has not been submitted in part or in full for any other degree or diploma in any other University.


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We recommend that this Dissertation be placed before the examiners for the evaluation for the award of the degree of **Master of Philosophy**.


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Abbreviations:

BJP: Bharatiya Janata Party
BOA: Board of Approval
CII: Confederation of Indian Industries
CPI (M): Communist Party of India (Marxist)
DC: Development Commissioner
DTA: Domestic Tariffs Area
Egom: Empowered Group of Ministries
EIA: Environment Impact Assessment
EOU: Export Oriented Units
EPZ: Export Processing Zones
EXIM policy: Export Import policy
FDI: Foreign Direct Investment
FTZ: Free Trade Zones
IMF: International Monetary Funds
LAA: Land Acquisition Act
MOCI: Ministry of Commerce and Industry
NDA: National Democratic Alliance
NEP: New Economic Policy
NRI: Non Resident Indians
PIL: Public Interest Litigation
R & R: Resettlement and Rehabilitation
RBI: Reserve Bank of India
SDA: SEZ development Authority
SEZ: Special Economic Zones
SIA: Social Impact Assessment
UPA: United Progressive Alliance
WB: World Bank

Chapter 1

Centralization and Growth in Indian Federalism

The most important challenge met by India soon after independence was of - 'maintaining unity and integrity' of the nation. India needed a system of co-existence, which would ensure both, liberties to different units as well as maintain cohesion of the same. The constituent assembly, therefore adopted federalism as the basic principle to achieve the twin objectives. However, many scholars and political entities were extremely skeptical of this 'Union of states'¹ and believed that it would not survive for a long period. Today, Indian Union has survived sixty long years and has also succeeded in buttressing democracy in India. Further, it has qualitatively evolved over the years, which is evident from the gradual shift from centralization to decentralization.

Liberalization has been the single most important factor that has influenced all the aspects of Indian polity since 1990s. Indian Union has not been immune to it. Rather it has been immensely influenced and altered by the process of liberalization. It is being argued that liberalization is leading to dismantling of the centralized structure. This is the focal point of my exploration. An attempt has been made to investigate the relationship between liberalization and decentralization of Indian federation. Further, the study makes an attempt to examine 'formally' as well as 'substantively' the nature and extent of decentralization.

This is augmented with the study of special economic zones introduced as a growth strategy under the scheme of liberalization. It is argued that if a growth strategy is 'inclusive' only then can it lead to real decentralization. Social cohesion and harmony of interests are the two measures which can determine whether a policy is inclusive or not and reinforce federalism. Lastly, an attempt is also made to see how an 'inclusive' growth strategy can be worked out in a federal polity.

¹ 'The members of constituent assembly did not use the word 'federation' in the constitution. Instead, they preferred to define Indian polity as a 'Union of States'. This issue is explained in detail later.

The first chapter aims at giving a brief historical background of the Indian federation until the time liberalization was introduced and new economic policies came to be adopted. Such an exercise is pertinent, if one needs to understand the true nature of Indian federalism and the process of decentralization. In addition, liberalization is not the sole process, which led to dismantling of centralized structure. Other processes and events also spurred decentralization. An understanding of such factors is essential to explore further.

Based on the above, the first chapter has three parts. The first part deals with basic issues like- what is federalism, why India adopted the ideology of federalism, its constitutional profile and nature. The second part deals with the various phases of federalism examined with the help of four factors- party system, developmental strategy, the issue of maintaining growth and unity and changing terms of trade between agriculture and industry. The last part specifically looks into the changes brought in by liberalization, post 1990s. It also attempts to outline the problem area.

Federalism and its variants:

The term 'Federalism' is derived from the Latin word 'Foedus' meaning treaty or agreement. Therefore, a nation, which comes into existence through a contract, treaty, or agreement between various units, is a federation. However, 'there is neither an accepted theory of federalism, nor any agreement as to its real nature'.² Federalism has numerous manifestations and definitions. This is because the theoretical formulation of federalism from a legal normative approach does not relate to the actual working of the federal systems. The latter is defined through behavioral empirical approach which emphasizes more on the political processes rather than 'what ought to be'. If the actual functional model of federalisms world over were studied, varied forms of it would be discovered.

² Ray, S. N. 2004. *Modern Comparative Politics: Approaches, Methods and Issues*, New Delhi: Prentice Hall of India, p.7.

Therefore, keeping in view that idea of federalism has no specific manifestation; Ronald L. Watts gives the commonly accepted definition. According to him, federalism means 'self-rule as well as shared rule'.³ A Federation consequently is a "combination of shared rule for some purposes and regional self rule for others; within a single political system, so that neither is subordinate to the other".⁴ This definition relates to a system of collective co-existence where the powers and responsibilities are divided between the national and the state governments giving them opportunity of both, self-rule as well as shared rule. The concept of federalism can also be embedded as an ideology within a territory. As an ideology, federalism refers to a principle of living together and accommodating, through a set of practices, ideas, terms and conditions put forth and envisioned by the people and the leaders of the nation⁵.

India's Federal Structure: Historical Overview

The nature of Indian federalism is quite different because of its historical evolution. To understand the nature we need to delve into the reasons as to why India adopted federal framework. Indian society has always been marked by immense plurality. India's plural-federal character is apparent in practically every major aspect of its collective life, be it social systems, economic formulations, cultural- patterns; or language- dialect groupings, religious communities, castes, sub-castes and sects; or local variations of commonly prevalent mythologies and commonly revered deities; or ethnic identities, regional alignments and sub-regional attachments; or diversities of history marked by moments of triumphs and tragedies of differences in heroes and villains, and in rich tapestry of folklore, folk dance, music, cuisine, crafts and artefacts of life.⁶ To reconcile between two opposite values 'order' established by a governing body and 'liberty' demanded by various sections of a plural society, federalism became the singular choice.

³ Watts, R. L. 1999. *Comparing Federations*, Montreal and Kingston: Mc Gill- Queen's University Press, p.3.

⁴ Ibid.

⁵ See, Kothari, Rajni . 1989. 'Decentralization: the Real Issue', *Monthly Public Opinion Surveys*, Vol. XXXIV, Nos. 1 & 2, Oct. & Nov., p. 4.

⁶ Khan, Rasheeduddin. 1992. *Federal India: A Design for Change*, New Delhi: Vikas Publication House Pvt Ltd, p: 8.

Second, India was a British colony for nearly two hundred years. Hence, the lingering effect of British administrative structure can be seen in the kind of federal setup, the framers of the Indian constitution had adopted. The Government of India Act of 1919⁷ and 1935⁸, mentioned about establishing a federal system. The makers of Indian constitution drew inspiration from these acts not only in terms of how to establish a federal structure but also to maintain a strong centre.

Third, to achieve unity in the Indian subcontinent (between Muslims demanding separate nationhood, around 600 princely states and forging links with rest of India) not by coercion but by constitutionalism, federalism became an obvious choice. Giving substantive autonomy to the regions demanding separate nationhood, was the only alternative to the ensure unity and integrity of Indian state.

Nature of Indian Union:

Indian federalism is not an identical adaptation of any other. The factors that created the need to adopt federalism as an operative principle also contributed in giving specific shape to it. Based on these factors the nature of Indian federalism can be delineated. First, the nature of Indian federation is quite different from the Western understanding of federalism. For instance, in America the federal union was formed through a process where several states united voluntarily under a central authority. Hence, it is a move towards the centre. However, in the Indian case the reverse is true.

⁷ 'This act introduced provincial diarchy; that is, some "nation building" subjects, such as education, would be in the hands of ministers commanding support in the provincial legislature while the core subjects, for example, law and order and finance, were in the charge of officials appointed by, and responsible to, the governor and ultimately to the British Parliament' - <http://en.wikipedia.org> (date of access: 28/07/2007)

⁸ 'This act provided for the distribution of legislative jurisdictions with three-fold division of power in federal, provincial and concurrent lists. The Act enabled the establishment of a federal court to adjudicate the dispute of units of the federation and was also the appellate court to decide on the constitutional questions. On the fiscal front, the Act provided an assignment of tax authorities and a scheme of revenue sharing that, in many respects, laid the foundations of fiscal federalism in Independent India'. – See Rao, Govinda M. and Nirvikar, Singh. 2005. *The Political Economy of Federalism in India*, New Delhi: Oxford University Press, p. 45.

Under the British regime, India was under a centralized authority. Since 1935, there has been an attempt to decentralize the powers from the Union to the states by dividing it into units. 'Neither the provinces nor the princely states were homogeneous from the point of view of language and tradition of their inhabitants.'⁹ Therefore, division on the basis of heterogeneity was done. Under the Government of India Act of 1935, new autonomous provinces were created and combined into a federation. After independence, the linguistic reorganizations of the states in 1956 is an example of the same. Hence, Indian federal movement has been a move from the Union to the states. Therefore, Indian federalism is devolutionary as against integrated federalism in U.S.

Second, Indian federation since its origin had a strong centre. During the British rule, all powers were centralized. 'This was' according to Granville Austin 'an imperial as well as administrative necessity'.¹⁰ Nevertheless, Indian National Congress that demanded devolution of powers between the centre and the provinces fervently opposed it. However, immediately after independence, the compulsions faced by the framers of the Indian Constitution made it imperative to achieve a balance between federalism and centralism. Nehru wrote in 1936 'It is likely that free India may be a federation, though in any event there must be a great deal of unitary control'.¹¹ To mitigate the ills of partition, maintain integrity of nation, deal with various fissiparous tendencies and divisive forces, ensure meteoric economic growth and reconstruction, skillfully maneuvering international crisis of cold-war and command respect from nations of the world all impelled constituent assembly to adopt a centralized federation. The Union powers committee, in the final report of the Constituent Assembly on August 20, 1947, states: "We are unanimously of the view that it would be injurious to the interest of the country to provide for a weak central authority which would be incapable of ensuring peace, of coordinating vital matters of common concern and of speaking effectively for a whole country in the international sphere".¹² This bias towards centre was clearly reflected in various provisions of the constitution along with the secondary aspects of

⁹ Alexandrowicz, C.H. 1954. 'Is India a Federation?', in *The International and Comparative Law Quarterly*, Vol. 3, No. 3. (July), pp. 393-403.

¹⁰ Austin, Granville. 1966. *Indian Constitution: Cornerstone of a Nation*, Oxford: Clarendon Press, p. 188.

¹¹ *Ibid*, p.186

¹² Constitutional Assembly Debates, Vol. V, 1947, pp. 79-84.

Indian Federation.

The Indian Union and its Federal Constitution

An inquiry of the various provisions of the constitution of India will bring out both federal and unitary features of the Indian State. However, it is difficult to overlook the tilt towards the Centre. The provisions and features are discussed as under from four dimensions: legislative, administrative, financial and emergency provisions respectively. These aspects reflect the Constitution's tilt towards the Centre. Even though Indian constitution uses the word 'Union of states'¹³ as against the word 'Federation', the presence of various federal features cannot be denied. Constitution of India mentions about a dual system of government- Centre and states. The Centre and State both derive authority from the constitution, which is inviolable and is protected by an independent though integrated judiciary. The distribution of powers and responsibilities between the Centre and the states is mentioned in Part XI (Article 245-255) and seventh Schedule of the Indian constitution. The Seventh Schedule contains three list – Union list (97 Subjects), State list (66 items) and Concurrent list (47 subjects) under the jurisdiction of Centre, states and both Centre and states respectively. A tilt towards the centre is seen as the number of subjects under the Centre outweighs those mentioned in the states list. According to Prof. R. Khan, three conditions further expand the Centre's powers.¹⁴ First, Centre can make laws relating to subjects mentioned in the concurrent list if it is necessary to maintain uniformity in the Indian State. Second, the residue power- the touchstone of determining the federal balance- including taxation are vested in the Union parliament.¹⁵ Third, the Union parliament can makes laws mentioned in the State list if it

¹³ According to R. Khan 'Union of States' refers to a union which is 'in substance and functioning a variation of the federal, and not Unitarian, form of state and government. A union in essence, is a federation, with a strong Centre. A Union has pronounced centripetal tendencies and therefore exhibits propensity to centralize administration, governmental activities and political power. Even then a Union does not become a unitary state. It remains federal, with a bias towards the state'. - Khan, Rasheeduddin. 1992. *Federal India: A Design for Change*, New Delhi: Vikas Publication House Pvt Ltd, p. 47.

¹⁴ Ibid.

¹⁵ Op. cit., Rasheeduddin Khan, 1992, p.48

deems necessary in the larger interest of people.¹⁶ In addition to this, according to Articles 200-201, the president can veto over state legislation, under certain circumstances except a money bill. Articles 2 to 4, give authority to the Parliament to reorganize states or alter the boundaries of the states through a simple majority in the legislature. During this process, the consent of the state legislatures may not be taken.

The control of Union on the states in the area of administration is manifested not only in the existence and power of all India services, but also in the authority given to the Union to control the state and achieve coordination by (a) giving directions to the state governments (b) delegating Union functions to states, (c) providing grants to the states.¹⁷ The most contentious sphere of federal balance is that of finance. According to the constitution of India, the Union list contains 12 items of taxation besides the residuary powers of taxation and the state list contains 19 items of revenue. However, distribution of financial powers is not adequate to meet the gap between the functions allocated and adequate resources. Hence, to correct the imbalances, which might arise from the above gap, the constitution mentions following measures to mitigate the situation. These include¹⁸:

- a) Obligatory sharing of Union taxes on income
- b) Permissive sharing of Union duties
- c) Assignment of certain Union duties and taxes wholly to the states
- d) Provisions for giving financial assistance to the states in the form of grants and loans

Besides these provisions, the constitution provides for the establishment of finance commission. The aim of this commission is to make recommendations regarding the transfer of funds from Centre to the States. It has over the years also provided a basis and determined the principle of transfer of resources by way of shared taxes and grant-in-aid out of consolidated fund of India (Articles, 270, 272, 275 and 280). Besides Finance

¹⁶ 'These include not only issues like treaty obligation, agreement or convention with a foreign country or decisions arrived at in an international conference but also matters like education, industry, communications, mineral development, election to State legislatures etc'. –Rasheeduddin Khan 1992 op. cit.

¹⁷ Khan, Rasheeduddin. 1992. *Federal India: A Design for Change*, New Delhi: Vikas Publication House Pvt Ltd, p. 49

¹⁸ Ibid.

commission, an extra constitutional body, 'Planning Commission', was also created by a Cabinet resolution in 1950. This commission has been setup to give recommendations by working in close consultation with the economic ministries of the centre and the state governments. However, the problem of coordination has always arisen between the centre and the state governments.

Emergency provisions mentioned in Part XVII- Articles 352-60, prove the overwhelming power of the Centre. Three type of emergencies: National emergency (Article 352); Failure of the constitutional machinery in states (Article 356); Financial emergency (Article 360) can transform the federal structure of India into a unitary one by suspending the authority of the states and imposing central rule for a certain period of time (Article 356 and 365). Besides these four spheres features like single citizenship, the office of the governor, integrated judiciary, unequal representation of states and a flexible constitution all contribute in creating a bias towards the centre.

1.4 India's Federal Union: A Centralized Federation:

Immediately after the inaugural of the constitution in 1950, Indian federalism began to receive diverse, often contrasting and contradictory assessment at the hands of academic observers, both Indian and Western scholars. The centralized character of the Indian federation vis-à-vis the states' rights had baffled and preoccupied most of the observers. This was because of its difference from the world models of federalism. Number of opinions existed regarding the nature of Indian federation. For some it was not a federation at all, for others it was quasi, for few it was sui generis and yet others labeled it as cooperative federalism. There is a need to revisit these debates, to understand the true nature of Indian federation. In addition, it would illustrate the qualitative evolution undergone by it. Prof. K.C. Wheare described Indian federalism as 'a system of government which is quasi- federal.'¹⁹ Based on the federal model of United States and Australia, K.C. Wheare came up with the definition of federalism- 'the general and regional governments of a country shall be independent, each of the other, within its

¹⁹ Wheare, K.C. 1963. *Federal Government*, London: Oxford University Press, p. 27.

sphere.²⁰ When he applied the same definition to India, it did not fit in mainly because of Article 249 (the council of states can make laws with respect to any subjects mentioned in the state list), 352-60 (emergency provisions) and 371 (surcharge on certain duties and taxes for purposes of the Union). Hence, he declared that India is a 'unitary State with subsidiary federal features rather than a federal State with subsidiary unitary features'.²¹ Similarly, Ivor Jennings accepted India to be a 'federation with strong centralizing tendencies'.²² According to K.V. Rao, Centre was usurping the rights of the states and hence he had strong reservations about Indian federalism. He argued that 'there are federal features, but they are not strong enough to make India a federation at par with any known federations so far'.²³

However, various scholars who have a positive reading of Indian federalism have opposed such an understanding. Prof. Alexandrowicz, Paul Appleby, N. Srinivasan and G. Austin are opposed to the idea of quasi - federalism. G. Austin drawing from Professor A.H. Birch argues that Indian federalism represents a 'cooperative federalism'.²⁴ A cooperative federalism produces a strong centre, or general government, yet it does not necessarily result in weak provincial governments that are largely administrative agencies for central policies.²⁵ Indian federalism has demonstrated this. According to Appleby, since federal legislation get implemented only at the state level and by the states, and from the administrative point of view which makes the centre dependent on the states it can be concluded that India has a strong federal polity.²⁶ Both Srinivasan and Alexandrowich consider the federal character of the Indian constitution as

²⁰ Ibid, p. 97.

²¹ Op. cit., K.C. Wheare, 1963, p. 27.

²² See, Jennings, I. 1992. *Some Characteristics of the Indian Constitution*, Madras: Oxford University Press.

²³ Rao, K.V. 1961. *Parliamentary Democracy in India*, Calcutta: World Press Pvt Ltd, p. 328

²⁴ Cooperative federalism according to Birch, refers to 'the practice of administrative cooperation between general and regional governments, the partial dependence of the regional governments upon payments from the general governments and the fact that the general governments, by the use of conditional grants, frequently promote developments in matters which are constitutionally assigned to the regions'.- Birch, A.H. 1955. *Federalism, Finance, and Social Legislation in Canada, Australia and the United Nations*, London: Oxford University Press, p. 305. According to Austin, this definition applies to India with exception of conditional grants

²⁵ Austin, Granville. 1966. *Indian Constitution: Cornerstone of a Nation*, Oxford: Clarendon Press, p. 187.

²⁶ Appleby, P. 1953. *Public Administration in India*, New Delhi: Oxford University Press in Austin, Granville. 1966. *Indian Constitution: Cornerstone of a Nation*, Oxford: Clarendon Press, p. 187.

indisputable because Indian federalism is a *sui generis* or a unique case.²⁷

As already mentioned there is no manifestation of a utopian federation. It can vary from country to country. In this context, to argue that Indian Union is not a federation or at best is a 'quasi federation' might be inappropriate. At the same time, constitutional relations between the centre and the states, which represent a tilt towards the former also exists. This cannot be overlooked if the true nature of the Indian Union has to be deciphered. Existence of a variety of federations as well as the tilt towards the Centre in the Indian federation points that a 'Centralized Federation' exists in India. However, this reality has been altered fundamentally by various factors, which the constitution fails to reflect. A study of the different phases of development would bring out the shift from centralization to decentralization. There is also a need to mention all the phases to understand the exact nature of decentralization. Liberalization as a factor is necessary but not a sufficient condition. It only tells a part of the story. There are other important aspects, which spurred decentralization both directly or indirectly. Hence, a mention of those factors through the various phases will allow unfolding of the complete story of decentralization brought in especially after liberalization. Each phase is studied by looking at several factors, which influenced the federal character of the country. Among others the most important are:

- Party system
- The changing terms of trade between agriculture and industry
- Unity and integrity of the nation
- Welfare state and the development strategy adopted

The Development of Centre-State Relations:

One Party Dominance (1947-67)

After independence, India faced a number of problems. Further, several new changes needed to be introduced to ensure stability and growth of the newly formed nation.

²⁷ See, Alexandrowicz, C.H. 1954. 'Is India a Federation?' in *The International and Comparative Law Quarterly*, Vol. 3, No. 3. (July), pp.393-403.

Hence, the adoption of a paternalistic approach could not be avoided. As a natural corollary, not only the role of the government became strengthened but also within it the role of the central government came to be highlighted. Partly due to the constitutional structure and partly due to the conditions prevalent in the society state governments could not assume the same position. Nor were they trusted with the sizeable responsibility of maintaining unity and progress. Consequently, the strong centralized nature of Indian federation was quite evident. Below is a detail analysis of all the factors that led to the same.

History of independent India is closely tied with the history of the Congress party. We cannot begin to understand the nature of Indian federalism without mentioning the role the India National Congress Party played in the first few decades immediately after independence and the consequence of it thereafter. The first phase was that of Congress hegemony. Congress party won over two-third majority in the first three elections (1952, 1957 and 1961). It also won a majority of seats in the state assemblies of all the then existing states from 1952-62. The only exceptions were Jammu and Kashmir, Nagaland, and Kerala dominated by the National conference, Independents, and in alternation with the then United Communist Party of All-India led coalition respectively.²⁸ Congress party was able to command such a majority not because of coercion but because of its unique nature, which could be attributed to the role played by Jawaharlal Nehru. Under Nehru's leadership, the party succeeded on three accounts: a) development of party organization b) accommodation of diverse interests c) maintaining relationship with other parties.²⁹ Congress had a very efficient party organization. It showed the capacity to co-opt and absorb people from every strata of society. Further, it was able to share the resources it gained from the state power with these individuals who could crucially add to the support base of the party. This management of resources, at which many within the Congress organization excelled, was essential to the proper functioning of the 'conciliation machinery within the congress, at various levels and for different tasks,

²⁸ Sridharan, E. 2004. 'The Fragmentation of India Party System', in Zoya Hasan (ed) *Parties and Party Politics in India*, New Delhi: Oxford University Press, p. 205.

²⁹ Hasan, Zoya. 2004. 'Introduction' in (ed.) *Parties and Party Politics in India*, New Delhi: Oxford University Press, p. 9

which was almost constantly in operation, mediating in factional disputes, influencing political decisions in the states and districts.³⁰ With a strong party organization congress succeeded in doing two things: maintaining extensive patronage network and reconciling different interests. Similarly, opposition parties existed however, they did not succeed in defeating the congress in any elections. Hence, they played a very different role. According to Rajni Kothari, the ruling Congress party became 'a party of consensus' and the opposition parties were 'parties of pressure'. That is to say that opposition parties functioned by influencing members within the Congress. They opposed by making the Congress oppose.³¹ Therefore though Congress was a centrist party, various members within it reflected different ideologies and interests emanating from opposition parties. This made Congress 'a catch all umbrella party' encompassing all ideologies- Centrist, leftist and Rightist. All of this tremendously augmented the strength of the Congress in the Parliament in New Delhi and state legislative assemblies.

These features aided Nehru, according to Austin, to institutionalized centralization. Nevertheless, this centralization had a unique nature. Again, this centralization of powers, in the centre- state relations was not based on coercion rather it was based on consent. As already mentioned the ability of the party to bring in its ambit myriad views, interests and successfully solve fractional disputes made it possible for the states to exercise considerable autonomy under the 'national nanny' called Nehru. Not only was Nehru sensitive to the presence of state ministers, the latter also held views in agreement with him. Moreover, 'chief ministers so often successfully defied the Congress high command that one party general secretary in the sixties expressed the fear that a situation might arise "when state party chiefs would rule Parliament".³² Nehru also initiated the community development and Panchayati Raj programmes, which could have led to a degree of political decentralization and empowerment in the village.³³ However,

³⁰ Kothari, Rajni. 1964. 'The Congress System in India', *Asian Survey*, December, p. 1168.

³¹ Manor, James. 1988. 'Political Competition and Transformation of the Party System', in Atul Kohli (ed.), *India's Democracy: Changing State-Society Relations*, Princeton, NJ: Princeton University Press in Austin, Granville. 1999. *Working a democratic Constitution: A History of Indian Experience*, New Delhi: Oxford University Press, p. 566.

³² Austin, Granville. 1999. *Working a democratic Constitution: A History of Indian Experience*, New Delhi: Oxford University Press, p. 566

³³ *Ibid*, p. 566

these programmes did not succeed.

At the time of independence, the main problem faced by Indian State was that of national integration. After the shock of partition, the Centre intervened in a forceful manner in the states, which presented a challenge to the integrity of nation. This could be seen in the case of Princely states especially Kashmir and Hyderabad and communist insurrection in Telegana. Similarly, the linguistic demand of Punjabi – speaking population was dealt with strong hands as this state bordered Pakistan and so was a sensitive case. According to Nehru, any ‘flexible adjustment characteristic of federalism ought not to apply’ to this particular region.³⁴ The challenges to integrity also came from Assam and the whole of Northeast. Tension arising out of mass exodus in Assam from Bengal, and tribal people from Northeast (mainly Phizo and the Nagas) demanding autonomy was not paid any heed until 1962. Nevertheless, when it assumed dangerous shape in 1962, Centre took strong measures to suppress the political demands. The argument of national unity and security were invoked while doing so. However, in this case scenario, Austin asserted that the ‘accusations by Nehru’s critics that the country was being governed in a unitary fashion was unjustified, but centralization was a major motif of governance under him.’³⁵ Further, during the period 1947-57, the centre did yield to linguistic pressures in line with the ruling party’s commitment, during the nationalist struggle, to re-divide India into politically homogeneous states reflecting the country’s national unity in cultural/ linguistic diversity.³⁶ Therefore new states like Andhra Pradesh, Maharashtra, Gujarat and Karnataka were formed.

For a nation, which succeeded in attaining independence after 150 years of long historical struggle the objectives thereafter, was to maintain political and economic sovereignty and social justice. The growth strategy thus needed to be in consonance with these objectives. At the time of independence two main models of development existed-

³⁴ Sathymurthy, T.V. 1997. ‘Impact of Centre-State Relations on Indian Politics: An Interpretative Reckoning 1947-1987’, in Partha Chatterjee (ed). *State and Politics in India*, New Delhi: Oxford University Press, p. 240.

³⁵ Austin, Granville. 1999. *Working a democratic Constitution: A History of Indian Experience*, New Delhi: Oxford University Press, p. 567.

³⁶ Ibid, p. 239.

namely capitalism and socialism. Based on this, Nehru had three options available before him: Unrestrained free market capitalism, modified welfare-state capitalism and a communist state.³⁷ The path he chose was somewhere in between welfare capitalism and communist state which was consistent with the earlier mentioned objectives. That is, the model of social democracy was adopted because a) unlike communism it would not sacrifice the value of political democracy b) it would bring about distributive equity. This meant that the Gandhian model of decentralized village economy was rejected. Pandit Nehru claimed that 'the problem of poverty and unemployment of the national defense and economic regeneration in general cannot be solved without industrialization. As a step towards such industrialization a comprehensive scheme of national planning should be formulated'.³⁸ Hence, central planning aided with five-year plans, within a broad socialist framework was adopted. It was based on a plan of industrialization favoring fast growth of heavy industries in the state sector, with other sectors left free for the energies of private enterprises.³⁹ To bring the successful implementation of the five-year plans the presence of the State was felt in a big way. Moreover, since a lot of specialized technical knowledge was required for formulating the various schemes of planning commission, the people as well as the representatives of state assemblies were not a part of it. Besides this, the industrial policy resolution of 1948, resolutions on Zamindari abolition, nationalization of Reserve Bank of India and Airlines and Banking Regulation Act all confirmed the central government's intention of moving rapidly into a position of dominance in the Indian economy. More specifically related to centre-state relations were the three constitutional amendments- Third, Sixth and Seventh. They increased central authority by increasing Parliament's taxing power and New Delhi's authority over production of trade in foodstuffs and certain commodities.

³⁷ See Kaviraj, S. 1996. 'India: Dilemmas of Democratic Development', in Adrian Leftwich (ed.). *Development and Democracy*, Cambridge: Polity Press, pp.114-138.

³⁸ As quoted in S.S. Marathe. 1986. *Regulation and Development: The Indian Policy Experience of Controls over Industry*, New Delhi: Sage Publications, p. 69' in Kaviraj, S. 1996. 'India: Dilemmas of Democratic Development', in Adrian Leftwich (ed.). *Development and Democracy*, Cambridge: Polity Press, p.120.

³⁹ Kaviraj, S. 1996. 'India: Dilemmas of Democratic Development', in Adrian Leftwich (ed.). *Development and Democracy*, Cambridge: Polity Press, p.120.

As already stated, industrialization was given a lot of incentive by the Centre. This significantly contributed to the rise of national bourgeoisie. This was because overall the greatest beneficiary of the central planning and public sector expansion policies of the central government was the national bourgeoisie. Infact the opportunities presented by such an instrument of planning even helped them to expand and diversify. Consequently, they acquired a national wide operation base. Thus, for instance 'Marwari enterprise has acquired a base in such far off place as Calcutta, Madras, Hyderabad and Kanpur'.⁴⁰ This national identity as already mentioned was the result of national developmental strategies. More specially 'the expansion of industry throughout the country under the aegis of the state, the widening of the market accompanied by its penetration of wider and wider sections of population, the vastly increased scope for expansion of private industry in general and small and medium scale industries in particular, and the opening up of the whole of the country to entrepreneur for any part it wishing to invest, produce to sell, contributed to a process of economic unification of India and giving its rising industrial bourgeoisie a 'national' (as differentiated from a sectional, regional or partial) identity'.⁴¹ This in turn resulted in the growth of monopoly capitalism, mostly involving Gujarati, Parsi and Marwari enterprises. By 1950s political mobilization against such 'monopoly' took place which eventually acquired a regional dimension. For instance, in Maharashtra in the 1950s the state government consciously discriminated against Parsi and Gujarati capitalists and encouraged Maratha capital in the newly emerging industries like sugar and cotton textile.⁴²

On the other hand, agrarian economy of India presented a very different picture. Congress through the first three five year plans did little to transform the agriculture and bring it to a modern footing. Consequently 'the rise of a new class of more or less

⁴⁰ See, Baru, Sanjay. 2000. 'Economic Policy and Capitalism in India', in Francine R. Frankel, Zoya Hasan, Rajeev Bhargava and Balveer Arora (ed.). *Transforming India: Social and Political Dynamics of Democracy*, New Delhi: Oxford University Press.

⁴¹ Sathymurthy, T.V. 1997. 'Impact of Centre-State Relations on Indian Politics: An Interpretative Reckoning 1947-1987', in Partha Chatterjee (ed). *State and Politics in India*, New Delhi: Oxford University Press.

⁴² Baru, Sanjay. 2000. 'Economic Policy and Capitalism in India', in Francine R. Frankel, Zoya Hasan, Rajeev Bhargava and Balveer Arora (ed.). *Transforming India: Social and Political Dynamics of Democracy*, New Delhi: Oxford University Press, p. 209.

'capitalistically' oriented rich and middle peasantry (drawn largely from the rank of the tenantry of the colonial era) on the one hand, and on the other, the emergence of a 'wage' conscious landless labor class and poor peasantry (in place of bonded serfs in a state of perpetual indebtedness) with a potential claim to the land tilled by them, was a slow process, the full dynamics of which had not yet begun to unfold itself'.⁴³ Hence, until 1967, by and large the economy was centralized as it was dominated by the national bourgeoisie who were fostered by the Centre's policies. During this period no really conflict emerged between the national monopoly bourgeoisie and regional non-monopoly capitalist as the latter yet had to emerge in a big way. The umbrella party successfully mitigated whatever little tension arose between the two.

Culmination of Emergence (1967- 77)

This phase in the history of Indian federation perhaps reflects one of the most acute forms of centralization. The reasons for this can be attributed to both the difficult problems of governance during this period and Indira Gandhi's drive for personal power. During the period of 1967, Congress won only 283 seats in the parliament that was lowest since the time of independence. Further, it lost power in eight out of sixteen states. According to Morris- James, the shift from Congress monopoly to competition offered by various other parties explains poor performance of Congress in the elections. He argues that since 1967 'market polity' emerged on the Indian political scene.⁴⁴ This was due to the inability of the congress to further absorb opposing groups within its ambit. This is not to suggest that competition did not exist during the earlier phase. There was a lot of competition and bargaining among different groups. However it was resolved within the party itself. Since this mechanism no longer succeeded in containing fractions, they emerged as dissenters and formed coalitions to defeat Congress. By 1969, Congress party also split into two and marked the beginning of intra-state conflict.

In 1971, Mrs. Indira Gandhi came to power with two-third majority in the parliament.

⁴³ Sathymurthy, T.V. 1997. 'Impact of Centre-State Relations on Indian Politics: An Interpretative Reckoning 1947-1987', in Partha Chatterjee (ed). *State and Politics in India*, New Delhi: Oxford University Press. p. 242

⁴⁴ See, Morris-Jones. 1978. *Politics Mainly Indian*, Madras: Orient Longman, pp.144-159.

Within her party, Mrs. Gandhi adopted a very aggressive stand. At the same time, she also 'adopted a more confrontational posture, both towards opposition parties at the national level and towards opposition-controlled government in various states'.⁴⁵ Although this according to Kochanek, 'prevented threats to her personal power', it centralized the decision making role, weakened the institutions and created an overly personalized regime. That is, party's organization and its accommodative capacity was destroyed and what was left was 'a pyramidal decision- making structure in party and government'⁴⁶ with Mrs. Gandhi at the top.

The decade of 1960s was also that of first wave of democratic upsurge. There was an increase in the participation of the voters. In 1962, the voters' turnout in Lok Sabha elections was 55.4 as against 47.7% of 1957 and in 1967 it was 61.3 %. Participation of people from 'lower' castes also increased. Further alternatives to the one party dominance began to emerge. For instance, we see the rise of parties like Janata Party at national level and DMK at the regional level during that period. This upsurge definitely had an impact on Indian federalism.

Hence, from this we may conclude that Mrs. Gandhi ascension to prime ministry was a watershed in the centre-state relations. State governments no longer had any sphere of independent functioning. 'Even the chief ministers were appointed by the Centre. No one with a mass base was allowed to come up. The states had become virtually the Zamindaris of the Centre....and the Centre, too, had become the handmaid of the Prime Minister.'⁴⁷ President's rule was imposed twenty-two times during the years 1967-73. Mrs. Gandhi even amended the constitutional provisions, which resulted in greater centralization. 44th (empowers parliament to amend or repeal any provision of constitution) and 25th Amendment Acts (which made Article 19 subordinate to major directive principles) are examples of this. Hence, 'Civil liberties and the character of

⁴⁵ Dua, Bhagwan D .1979. *The Presidential rule in India, 1950-1974: A Study in Crisis Politics*, New Delhi: S. Chand in Austin, Granville. 1999. *Working a democratic Constitution: A History of Indian Experience*, New Delhi: Oxford University Press, p. 568.

⁴⁶ Kochanek, Stanley A. 1976. 'Mrs. Gandhi's Pyramid: The New Congress', in Henry C. Hart (ed.), *Indira Gandhi's India*, Boulder, CO: Westview, pp. 104-5.

⁴⁷ Austin, Granville. 1999. *Working a democratic Constitution: A History of Indian Experience*, New Delhi: Oxford University Press, p. 568.

Centre state relations had been placed in the care of an obedient Parliament and the persons upon Mrs. Gandhi's favor'.⁴⁸ In addition to all this even the independence of Judiciary was threatened by neutering the Supreme Court. This was done as only judiciary has the capacity to interpret the constitution and based on it resolve disputes relating to centre-state relations. Infact, chief ministers from various states particularly Tamil Nadu, Assam and Orissa pleaded for 'real federalism'.⁴⁹ The Rajamannar Commission report published by the government of Tamil Nadu in 1971 raised similar concern. This gave opportunity to the opposition to come up in a big way especially under the leadership of Jayaprakash Narayan by 1974.

Hence a crisis in the society was arising which ultimately culminated in declaration of emergency by Indira Gandhi by 1975. During the two years of 'declared emergency' centralization reached its peak. Dissenters both at national and state level were forcefully silenced. However, this emergency epitomizing centralization ironically produced the opposite effect. It further led to regional assertion in a more powerful manner.

In the sphere of economy, centralization took in the form of bureaucratic control. Various measures like nationalization, abolition of privy purses etc extended the central governments control of the economy. The centralization was to such an extent that L.K. Jha, Mrs. Gandhi's own personal secretary, said that 'the worst victim of the centralization psychosis which afflicts many governments is the public sector'.⁵⁰

On a macro level, industrial growth stagnated to about 4 per cent in the period from 1964 to 1976. Besides, the inefficiencies of the Public sector, the economic planners recognized that the constraint on industrial growth was the lack of surplus generated by

⁴⁸ Ibid, pp. 570

⁴⁹ See Administrative reforms report, 1-7 July 1968, p.8400 in *The Presidential rule in India, 1950-1974: A Study in Crisis Politics*, New Delhi: S. Chand in Austin, Granville. 1999. *Working a democratic Constitution: A History of Indian Experience*, New Delhi: Oxford University Press, p. 568.

⁵⁰ Quoted by C. Rajagopalachari in his 'Dear Reader' column in *Swarajya*, 18 March, 1967, p.29 in *The Presidential rule in India, 1950-1974: A Study in Crisis Politics*, New Delhi: S. Chand in Austin, Granville. 1999. *Working a democratic Constitution: A History of Indian Experience*, New Delhi: Oxford University Press, p. 568.

agriculture. Further, agriculture failed to provide employment in large numbers. Therefore, the scope of industrial diversification and production of mass consumer goods had become constricted. Concurrently there was a food crisis since population was growing rapidly. This impasse resulted in adoption of a new agricultural strategy in 1969 known as 'Green Revolution'.

One of the most important consequence of green revolution and increased attention to the agriculture in all the states was the emergence of new region based classes. Ravi Srivastava argued that 'there was a new rural elite which has benefited from the siphoning off of the increased flow of resources from the state' and began to exercise influence both at national and the regional level. So much so that these locally dominated classes emerged strong enough to threaten the position of congress at both centre and states. With passage of time there began 'a sharpening of the contradictions between the interests of the regional bourgeoisie- landlord classes and the aspiring sections of the petty- bourgeoisie in the states, on the one hand, and the interests represented by the Centre, on the other'.⁵¹ This was mainly because the region-based classes also needed a share in the political and economic power. They were no longer ready to accept the dominance of national industrial bourgeoisie through Congress. Moreover, in this sense they rejected the centralized structure that provided them with no power. They found an outlet through regional and state based parties, which were capable of articulating and enforcing the interest of regional elites. Hence, this period witnessed the growing assertiveness of power by the regionally dominant classes in the states as a response an increasing tendency towards centralization. T.V. Sathymurthy argues that the impetus for the Indian emergency was derived not from any contradiction between the different instruments of federal power representing the centre and the states, but predominantly from political challenges that sprang from outside. One of such political situation was the effort of congress to strengthen its position vis-à-vis these newly emerging classes.

⁵¹ Srivastava, Ravi. 1995. 'India's Unequal Development and its Implications for Political Processes: An Analysis of some Recent Trends in T.V. Sathyamurthy (ed.), *Industry and Agriculture since Independence*, vol. 2, New Delhi: Oxford University Press, p. 212.

From One Party Dominance to Competition (1977-1989)

In the history of Indian Federalism, the phase from 1977-1989 was a turbulent one. Both in terms of the changes in the polity (like- fragmentation of party system, rise of regional parties, democratic upsurge, cession movements, disillusionment from the state and political institutions) and in terms of the economy. Consequently, it marked a turning point for the Indian federation. Below is a brief summary of these factors:

This phase began with Janata Party, a flaccid coalition of Jana Sangh, Bharatiya Lok Dal, Socialist Party and erstwhile leader of Congress-O coming to power and Congress loosing at the centre for the first time. This seem to be an obvious outcome of emergency declared by Mrs. Gandhi as people were not ready to accept her hegemonic ways of ruling. However, the alternative accessible to people in place of Congress was a hastened coalition of several ideological different parties and competing leaders like Charan Singh, Morarji Desai and Jagjivan Ram. Hence, this coalition failed to achieve cohesion. This had a definite effect on centre-state relations. One result was loosening of ties between the national and state levels within both the Janata Party and the political system.⁵² The centre did not hold a tight leash over the state governments. According to G. Austin, there were instances of fraction between the Centre and several state governments, wherein the latter became more and more assertive. Further, since Janata Party was opposed to Congress, it dismissed several Congress led state governments. This strengthened the position of regional parties. Janata party took a step further in favoring the states. It abolished the article which allowed the deployment of paramilitary forces by the centre in the states without latter's permission. Janata party also made the declaration of President's rule in the states stringent. Over all, 'relations between New Delhi (Union) and the states were comparatively untroubled during Janata government.'⁵³ All this contributed in paving the way for gradual decentralizing.

Janata Party lost majority in July 1979, and Mrs. Gandhi came to power. This brought in a reversal of trends. Infact the relations between the centre and the states were most

⁵² Ibid, pp. 447.

⁵³ Austin, Granville. 1999. *Working a democratic Constitution: A History of Indian Experience*, New Delhi: Oxford University Press, p. 572.

beleaguered during this period and thus inhibited the growth of federal culture. One of the main reasons for this, besides Mrs. Gandhi's need to personal power, was the threat of secession coming from states of Punjab, Kashmir and North-eastern States. Her highhandedness in dealing with these states aggressively and unconstitutionally led to her assassination on 31st October 1984. During her tenure, she appointed Sarkaria Commission to look into the issue of centre-state relations. According to Austin, it was a measure taken to 'side track' the constitutional revolt of chief ministers belonging to oppositional parties.⁵⁴ Recommendations made by Sarkaria commission were not implemented earnestly.

This phase hence affirmed the deinstitutionalization because of the Mrs. Gandhi's rule. It witnessed the decay of political institutions as their functioning ceased to exist according to rules and procedures. Rather, they worked according to the wishes of the leaders. Hence, the institutions failed to respond effectively and sensitively to the needs of the society. Concurrently, as mentioned earlier, due to the democratic upsurge, people become more and more assertive. They became aware about the electoral logic and ceased to vote based on their past loyalties. According to Kothari, they not only expected the government to perform but also to allow them a share in the political power acutely centralized until now. This contradiction between 'demand and outcome' put forth by the political institutions especially the Congress party, forced masses to look for alternatives.

Death of Mrs. Gandhi ensured victory for her son Rajiv Gandhi. He succeeded in getting the highest number of sympathy votes ever won by Congress (48.1%). Rajiv Gandhi was more liberal in dealing with the opposition parties at the state level and the regional movements as compared to his mother. This can be seen in the case of Karnataka, Andhra Pradesh, Assam and Punjab. However, the state policies introduced by Rajiv Gandhi were populist and rhetorical in nature. They were meant to appease the powerful classes of the society. According to Prof. Zoya Hasan, the party did not have the power to implement radical policies like 'Garibi Hatao', which the society expected. Masses were becoming increasingly disillusioned by the state and consequently there was a

⁵⁴ Ibid, p. 571

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growing divergence between the society and the state.

From the federal perspective, this phase is very important. This is because both fragmentation of party system especially from 1977 to 1984 and the rise of regional parties took place in this period. It was a time characterized by abundant alternation between parties in power in the state and national levels, by continued decay and fragmentation within parties, by a tendency towards personalized control of parties or splinters by eminent and not so eminent politicians, and by great fluidity with the party system as factions and rumps and individuals defected or realigned themselves this way and that⁵⁵. Further, since 1985 there has been a sudden rise of number of regional and state based parties. According to Zoya Hasan, there are four main reasons for this:

- a. At the institutional level, though Indian constitution shows a tilt towards the Centre but it allows a framework in which national and regional parties can co-exist. The loosening of the Congress hold, contributed to the emergence of parties at different level.
- b. Rise of regional parties took place partly due to a reaction to over centralization and partly because it was a natural development.
- c. Three most important issues - Ayodhya, Mandal and Market (3 Ms) led to depletion of Congress's vote bank especially from the Hindi speaking belt. It realigned the masses with other parties such as BJP, BSP etc. through which they found a voice.
- d. The single most important source of change was the entry of the propertied intermediate and middle castes, the chief beneficiaries of commercialization of agriculture in last few decades.⁵⁶ The interest of these 'regional, non-monopoly agricultural based capitalists', came to be represented by the regional parties, which gained their support.

On the economic front, the culmination of balance of payment crisis began which led to

⁵⁵ Manor, James. 1988. 'Political Competition and Transformation of the Party System', in Atul Kohli (ed.), *India's Democracy: Changing State-Society Relations*, Princeton, NJ: Princeton University Press, p.445

⁵⁶ Hasan, Zoya. 2004. 'The New Power Centres', *Frontline*, April 23, p.6.

decentralization in later phase. From experience, it was learned that agriculture needed to be developed if growth and diversification of the industrial sector has to be maintained. However, with the liberalization of the trade regime that began in 1970s, the focus on industrialization was brought back. This was because more technological and physical capital goods needed for industries were imported. Due to Indo-China and Indo- Pakistan wars, there was a massive increase in the imports of expensive weaponry at the same time, while our exports and the remittance received from the Non Resident Indians remained modest. Further, our exports were of primary goods as against our imports that were mainly finished goods. Therefore a huge trade gap developed. The combined effect of all this was that the current account deficit (which provides a rough measure of our borrowing abroad every year) doubled from an annual average of \$ 2.3 billion (1.3 % of GDP) in the first half of the 1980s to an annual average of \$ 5.5 billion (2.2% of GDP) in the second half of the 1980s.⁵⁷ To improve this condition the government took loans from international financial institutions at regular intervals. Hence the external debt multiplied by more than two- and – a half in a decade ; from \$ 23.8 Billions at the end of the 1980-1981 to \$ 63.3 billion at the end of 1990-91. Consequently, there was a dip in the foreign exchange creating conditions for balance of payment crisis. Hence, it can be concluded that factors that propelled the shift from centralization to decentralization had taken grounds most conspicuously during this phase.

New Power Centres (Post 1990s)

The meteoric growth of regional parties, since the last few years became the most important factor both in determining the nature of Indian Politics and in shaping the Indian federalism. Scholars argue that this has resulted in constituting the states as the 'new power centres' wherein politics has shifted from Centre to the states. After five tumbling governments one after another until 1999, what became clear was that regional parties had come to determine the fate of national parties. Looking at the role regional parties played it can be conclusively said that they are both 'kingmakers and partners in

⁵⁷ Nayyar, Deepak and Amit Bhaduri. 1996. *The Intelligent Person's Guide to Liberalization*, New Delhi: Penguin, p. 25.

power'.⁵⁸ By 1994 according to James Manor, national party system was broken down into three main elements: a) BJP (Bharatiya Janata Party) b) Congress c) Array of parties and fragments of parties- CPI and CPI(M), TDP, AGP, Akali Dal, BSP etc. In 1996, regional parties managed to install India's first non- hindi speaking Prime Minister; Mr. H.D. Deve Gowda. Further, BJP government was able to establish a government at the centre in 1998 with the support of regional parties: Telugu Desam Party, Dravida Munnetra Kazhagam, All India Anna Dravida Munnetra Kazhagam, Trinamul Congress, Akali Dal, Samata Party, Biju Janata Dal and Samata Party. TDP among others played the most crucial role in maintaining BJP at the centre. No one was left in doubt of the enormity of the transition from 'one party' dominance to regionally driven coalition parties. This is in sharp contrast with the past when regional and State existed at the pleasure of strong Central government.⁵⁹ 1999 elections restored back the normalcy in terms of tenure of the government. State parties, aggressively pursuing the developmental interests of their respective states, joined hands with the BJP after the dissolution of 12th Lok Sabha in an alliance which marked the advent of 'electoral federalism'.⁶⁰ All of this has brought tremendous change in the centre state relations. Therefore 'a literal reading of the Indian Constitution can be misleading today because it does not convey the extent to which regional identities and federalism have taken roots in contemporary political life through the operation of the party system. Though it has been amended eighty-three times, the constitution still does not reflect these changing political realities which have modified the 'Strong centre-state framework' by placing de facto curbs on the centre's sweeping powers of unilateral initiative and intervention'.⁶¹

Another factor, which needs to be mentioned, is the severe balance of payment crisis faced by India in 1991. As already mentioned the fiscal deficits (when the revenue is less than the expenditure of the government) and current account deficit (i.e. the trade account where receipts from foreigners in hard currencies like US dollar is less than the payment

⁵⁸ Hasan, Zoya. 2004. 'The New Power Centres', *Frontline*, April 23, p.4-5.

⁵⁹ Ibid, p. 4

⁶⁰ Arora, Balveer. 2000. Political Parties and Party System: The Emergence of New Coalitions', in Subhash C. Kashyap, D.D. Khanna and Gert W. Kueck (eds.), *Reviewing the Constitution?* New Delhi: Shipra, p.178.

⁶¹ Arora, Balveer. 2001. 'Coalitions, Reforms and the New Federal Polity', *Social Action*, Vol.51, July-Sept, p.293.

made to foreigners) led to this crisis. To remedy the situation India borrowed money from International Monetary Fund. This was based on the condition that the domestic government would introduce policies of macro-economic stabilization⁶² combined with fiscal adjustment and structural reform⁶³. Policies for macro economic stabilization included introducing fiscal discipline to bring Balance of Payments and the governments' budget deficit under control. Consequently, the monetary transfers to the states from the central government were restricted. However, the states were still in dire need for funds. To solve this problem India was transformed into an open economy by embracing policies of fiscal adjustments and structural reforms. Further, changes were brought in the 'structures of incentives and institutions in favor of private initiative and against state intervention'.⁶⁴ Inevitably, dismantling of an array of controls took place. The central government gave up exercising many of its inherent powers in the economic field. There was constructed decentralization and the state governments were given the responsibility as well as the autonomy to develop their own economies. The Indian State from being an interventionist state now became a regulatory state fostering market competition.

In the institutional sense, this has led to diminished roles of executive and legislature i.e. less scope for cabinet and parliament and enhanced the role of regulatory institutions- i.e. more scope for Supreme Court, election commission and the President. The role of these regulatory institutions are more procedural than substantive, more ruling and enforcing than law making and policy making. The regulatory institutions are needed not only to create, sustain and perfect markets, but also to ensure procedural fairness in the election and operation of multiparty system and formation and conduct of coalition governments

⁶² 'The meaning of Stabilization in economics is much the same as in medicine: just as medical treatment seeks to stabilize the health of the patient in critical condition, economic management attempts to stabilize an economy in deep crisis', - Nayyar, Deepak and Amit Bhaduri. 1996. *The Intelligent Person's Guide to Liberalization*, New Delhi: Penguin, p. 30. IMF style of structural adjustment uses a) fiscal policy of the government and b) the monetary policy of the central government to reduce the deficits and thus stabilize the balance of payment crisis.

⁶³ This means embracing the Policies of Liberalization, Privatization and Globalization.

⁶⁴ Nayyar, Deepak and Amit Bhaduri. 1996. *The Intelligent Person's Guide to Liberalization*, New Delhi: Penguin, p. 31.

in a federal government.⁶⁵

The above-mentioned trends have created an opening for a decentralized structure to emerge. In this context, an effort is made to study the nature and degree of Indian federalism through the process of decentralization. This is not to equate federalism with decentralization. Rather the idea is to use decentralization, a key factor in determining the nature of federalism, as a yardstick for the same. This decentralization is seen from two perspectives: Political and Economic examined below:

Economic Liberalization and Political Decentralization

Prof. Raja Chelliah in 1996 argued that 'the relative spheres of activities of the two levels of the government have been thrown into a flux. The scope for real decentralization of economic power has been greatly increased and new vistas have opened up for creative and innovative activities by the sub-national level governments'.⁶⁶ This political decentralization between the different levels of government has been a result of three interrelated factors. First, after the crisis of 1991, fiscal adjustments and reforms made it imperative to dismantle controls and rely more on market forces for growth. Hence, the strong intervention of the Centre through five-year plans, financial and planning commission and various developmental policies has greatly been reduced. Rather, the Centre has become a guide showing the broad national objectives and targets which the states have to abide. Hence, there has been a retreat of the central government. It intervenes only to maintain fiscal discipline and ensure transparency and accountability.

Second, 'the decline of central public investment and the growth of private investment gave the federal states, the immediate sites of private investment, a greatly expanded role

⁶⁵ Rudolph L and Susanne Hoerber Rudolph .2001. 'Redoing the Constitutional Design: from an Interventionist to a Regulatory State', in Atul Kolhi (ed.) *The success of Indian Democracy*, New York: Cambridge University Press, p.254.

⁶⁶ Chelliah, Raja. 1996. *Towards Sustainable Growth: Essays in Fiscal and Financial Sector Reforms in India*, New Delhi: Oxford university Press, p.19.

in economic liberalization and in promoting investment and growth'.⁶⁷ This is because states now have to fend for themselves in the open market if they want to achieve growth and prosperity possible only through private investments. Consequently, the economic liberty to do this by making independent economic decisions, laws, procedures, chalking out a course of action and implementing it began to rest within the domain of the states. The onus of development passed in the hands of the state. Each state has now become the maker of its own destiny⁶⁸. Infact the agency of the states have been evoked to transform their economic situation. According to Rudolphs, the Chief Ministers have started acting as 'entrepreneurs' of their states. These states can be compared to firms that need to market itself for survival, better investments and opportunities for expansion. This has been irrespective of the kind of ideologies the chief ministers follow. For instance, Jyoti Basu, the long serving communist chief minister of Bengal, took the lead in aggressively wooing job and revenue generating capital.⁶⁹ Therefore the chief ministers 'are seen on the front pages, covers of news magazines and television screens, making and breaking coalition governments, welcoming foreign statesmen and investors, dealing with natural disasters and domestic violence.'⁷⁰ In this sense, features of real federalism have surfaced where states are actually taking command of themselves. State governments have adopted 'New Economic Policies' based on decentralized structures which would allow states to develop there own economy. One such economic policy is the establishment of Special Economic Zones.

Lastly, political decentralization has also been a result of the division of responsibilities in the Indian Constitution. S. Guhan argues that most of the key sectors salient to the adjustment process lies within the primary jurisdiction of the states: Industrial infrastructure, power development, agriculture, allied sectors and irrigation; roads, other than national highways; social sectors such as education, health and medical services,

⁶⁷ Rudolph, Lloyd and Susanne Rudolph. 2001. "Iconization of Chandrababu: Sharing Sovereignty in India's Federal Market Economy", *Economic and Political Weekly*, May 5, p. 1544.

⁶⁸ One example of this has been the deal negotiated by the Maharashtra's Chief Minister with Texas energy giant Enron. The Cabinet and the finance minister opposed this decision but the government of India was forced into providing sovereign counter-guarantee to government of Maharashtra in September, 1994.

⁶⁹ Rudolph, Lloyd and Susanne Rudolph. 2001. "Iconization of Chandrababu: Sharing Sovereignty in India's Federal Market Economy", *Economic and Political Weekly*, May 5, p. 1542.

⁷⁰ Ibid, p. 1541

nutrition, water supply and urban development fall in the category of state or concurrent list.⁷¹ Further, with the adoption of 'New Economic Policies' there has been a shift in the role of the government from activities hitherto controlled by Centre- notably, industrial regulation - to those which mainly fall with the sphere of the states such as social welfare and infrastructure for agriculture and industries

Through these factors, one can argue that political decentralization has taken place and has contributed in changing the nature of Indian federalism. A more in-depth analysis of these factors is undertaken in Chapter 4, where the issue of third tier, powers and responsibilities is also discussed. To make this study possible as well as empirical the case study of Special Economic Zones is undertaken. This policy, introduced in 2005 can help scrutinize the process of decentralization.

The discussion of these factors point towards another important issue. Is it sufficient to study a concept only in its formal sense? Should decentralization be concerned only with the legal-politico structure of what federalism holds, at different levels of the government? Obviously, a substantive approach is needed if a thorough examination has to be done. This brings us back to what 'federalism' means. As already stated federalism is not just a means of distribution of powers and responsibility between centre and the states. It also refers to a model of co-existence as imagined, aimed, and strived by the society. Federalism than becomes a means to an end. Indian Constitution as already mentioned, does not use the terminology of federalism to designate the Indian polity. Article 1(1) of the Indian Constitution says 'India i.e. Bharat, shall be Union of States'. However, this was not to suggest that India is not a federation. Rather it directs us to go beyond the legal-politico structure of a federation and examine the conceptualization of the Indian society through the basic idea of federalism. It refers to the idea of accommodation through devolution of powers. That each is able to govern himself. Further, federalism as a principle aims to make available liberties to different units and groups and yet ensure social cohesion. This is especially true for India, whose founding

⁷¹ Guhan. S. 1995. 'Federalism and the New Political Economy in India', in Balveer Arora and Douglas V. Verney (eds.), *Multiple identities in a Single State: Indian Federalism in Comparative Perspective*, New Delhi: Konark Publishers Pvt Ltd, p. 241.

fathers believed in the principle of 'Unity in Diversity', and so preferred a federal form of government. Therefore, it is not adequate to explore the idea of federalism and through it decentralization in political sense. We need to analyze it, in the larger dynamics.

Several other dimensions- social, economical, and cultural should be considered. Not just because they are important but also because one reinforces the other. If economic, social and cultural liberties are guaranteed to the people, decentralization would be sustainable and meaningful. Until recently, a number of scholars have given emphasis to the study of maintaining social cohesion through accommodating socio-cultural diversities in India. However, few have taken into consideration the economic diversity as a unit of analysis within the Indian society. In global context, when the race for greater economic growth has ominously gripped the nations, ensuring proper distribution of the benefits of this growth in society has become a very vital factor for maintaining social cohesion. Here, like socio-cultural diversities the need to accommodate economically different located individuals is essential. Federalism has the capacity to do the same through devolution of powers. Hence, this study would aim to investigate the problem of economic diversity and social cohesion in a federal polity.

Inclusive Growth and Social Cohesion

In this context, it is important that we look at the issue of decentralization from both the perspectives: political and economic, to have a substantive examination of the issue. It is believed that through various growth strategies, under the schema of NEP, decentralization is being realized. However, at the same time we need to look at the economic impact of these growth strategies on the society. If they lead to actual devolution of economic power to the people and ensure their rights and liberties, then it makes political devolution of powers significant. Hence, a growth strategy needs to be 'inclusive'. That is to say, a growth strategy that merely leads to an increase in GDP or material sufficiency is not adequate. Rather a policy needs to be such that it leads to equity of distribution in the society. According to Montek Singh Ahluwalia, Deputy Chairman, Planning Commission, 'Any strategy that does not pay attention to economic

growth is going to be unsustainable. But you cannot rely on growth only. You have to ensure that the benefits of growth are widespread and you need special measures for those who would not normally get included. We need an "inclusive" growth strategy".⁷² Therefore, an inclusive growth strategy would ensure a) growth b) widespread and equitable distribution c) And concentrate on those aspects like income, poverty, education, infrastructure, health, women and children and environment which buttress the other two. Only such an 'inclusive' growth strategy can ensure harmony of interest within the society. Further, it can ensure socio-economical cohesion, which is a much sought after virtue of any federal polity.

The next section describes the structural constraints within which policies are made and how it affects social harmony and cohesion. Liberalization has led to an increased dependence on 'non-debt creating private capital investments'. For growth, the economy needs investment and this investment has to come mainly from private sector. According to the 11th five-year plan, an increase of 35.1% in the rates of investment from 27.8% in the 10th Plan is required to achieve a growth rate of 9%. According to the plan, half of this increase is expected to come from private investments.⁷³ The principles of market apply to the disposition of these private investments. Consequently, it has created conditions of competition between various states for private investments- both domestic and foreign. Rudolphs' argue that such an inter-state competition can take the form of race to the top or race to the bottom.⁷⁴ As already mentioned lack of public funds from the central government means that, the states have to increase their market value in the eye of private investors. They need to endorse themselves as viable zones of investments by providing skilled and committed labor, good infrastructure especially power, transportation and communication and good governance etc. However, this is not the

⁷² As quoted in G. Srinivasan .2005. 'We need an inclusive growth strategy' — Mr. Montek Singh Ahluwalia, Deputy Chairman, Planning Commission', *Business Line*, Thursday, March 5, Website: <http://www.thehindubusinessline.com/2005/03/03/stories/2005030300070800.htm>, date of access 5/12/2007.

⁷³ "Towards a faster and More Inclusive Growth, An Approach to the 11th Five Year Plan", Government of India, Commission Yojna Bhavan, New Delhi, 9th December 2006, Website: www.planningcommission.gov.in, date of access: 06.08.07., p. 100.

⁷⁴ Also see, Bardhan, Pranab. 2001. 'Sharing of spoils: group equity, development and democracy', in Atul Kohli (ed.) *The Success of Indian Democracy*, New Delhi: Cambridge University Press, pp. 226-241.

case with Indian states. M. Ahluwalia has empirically proved that one of the reasons why the growth rate of some states is poor is due to lack of infrastructure.⁷⁵ Even in the case of those states where these facilities are comparatively better, they do not seem to be at par with regions such as China, Malaysia etc. Hence they introduce a number of 'concessions' both economical and political. For example, liberal tax policies, land rights of the farmers, flexible labor laws and environmental policies etc. to allure private investment. However, such 'a policy [of] competition among the states that offers incentives to attract direct investment is akin to a prisoner's dilemma'. In that, it is collectively rational not to give incentives to attract direct investment, while at the same time it is individually rational to provide incentives'.⁷⁶ This accounts for not only variation in the degree of concession offered but also spiral increase in the concessions offered. For example, each state has its own policy in managing a Special Economic Zone. Following the policies of different states, it becomes evident that Maharashtra government offers more flexibility in Labor Laws as compared to West Bengal or Andhra Pradesh. If the concessions lead to greater investment in Maharashtra, other governments would soon follow to provide the same degree of concessions.

Consequently, two types of arguments have emerged. One stream, mainly those of liberals argue that the growth strategies may take time to stabilize before initial hiccups. However, in long term it will ensure both growth and social harmony. As soon as various growth strategies would be able to meet economic imperatives (of increasing employment, exports, better infrastructural facilities etc.) it would help society to move towards greater socio-economic cohesiveness. On the other hand, Marxists argue that the very idea of a capitalist state bringing in social cohesion through growth strategies is contradictory. Class difference within a society will always remain. Hence, benefit of any growth policy will always be limited to a section of population. In this context, decentralization is only partial and often undertaken in favor of bourgeoisie. These issues are dealt in detail in chapter-5, wherein the policy of Special Economic Zones would be

⁷⁵ See, Ahluwalia, Montek S. 2000. "Economic Performances of States in Post- Reforms Period", *Economic and Political Weekly*, 6th May, 1637-1648.

⁷⁶ Venkatesan R. and Sonalika Varma. 1998. *Study on Policy, Competition Among States in India for Attracting Direct Investment*, NCAER, October, New Delhi, p. 49.

measured with the yardstick of social cohesion and harmony of interests.

To mitigate the above it can be argued that the states can rely on agriculture where the chase for private investment is comparatively less. However, based on the past few years it can be inferred that over all the growth rate of agricultural sector has declined. According to the India portal website of government of India, 'Low and volatile growth rates in Indian agriculture and allied sectors was reflected in the average annual growth rate of value added in the sector declining from 4.7 per cent during the Eighth Plan (1992-1997) to 2.1 per cent during the Ninth Plan (1997-2002). From negative growth rate of -7.2 percent in 2002-03, the agriculture sector grew at a rate of 10.0 per cent in 2003-04 and at a rate of 6.0 per cent in 2005-06'.⁷⁷ Hence, heavy dependence on agriculture is neither feasible nor desirable. Concomitantly indiscriminate reliance on the service sector is not possible either. Service sector does not involve direct production of goods required to meet the basic consumption needs of the masses. Depending upon the foreign market for the same can lead to severe balance of payment crisis as has happened in the past in India. Service sector generates employment and income however if there is a dearth of basic consumption goods then it is a futile process. Service sector like the agriculture sector is highly volatile as it is susceptible to crisis developing in any part of world. Further, even if both the sectors are performing remarkably well, the need for a manufactory sector cannot be undermined in this globalized world. As this sector, utilizing the resources from the primary sector moves an economy to self – sufficiency and enhances the process of development.

Hence, what clearly emerges then is the necessity of formulating an 'inclusive growth strategy', which entails harmony of interests. This is the central premise of my investigation. The main purpose is to see how an inclusive growth policy can be worked out in a federal polity. The idea is to bring together two indispensable factors to ensure the success of a liberal federal polity. The factors are 'Growth' and 'Social Cohesion'. This would be worked out through the study of 'Special Economic Zones' policy. Therefore, chapter two exclusively deals with 'Special Economic Zones' policy.

⁷⁷ Website: http://india.gov.in/business/indian_economy/eco_indicators.php , Date of access: 23/11/07.

Chapter 2

Genesis and Nature of Special Economic Zones

In 1950's and 1960's, most of the developing countries adopted the policy of import substitution for greater domestic industrialization with an aim to achieve economic growth.¹ However, by the end of 1970s mostly all the developing countries, faced the crises of poor and at best uncompetitive and weak industrial enterprises. Consequently, they realized the need for a new economic strategy, which would eliminate the stagnation and boost industrial growth. Hence, the next best alternative was of export led industrialization. This marked the move away from import substitution to export-oriented growth and in a sense a substantial shift in the ideological anchoring.

It was not feasible for the developing countries to embrace full-fledged liberalization for export led industrialization, given their socialistic anchoring. The fear of the political and economic reaction this move would invoke from domestic politics and internal market prevented many countries to accept the principles of an open economy. It was here that the idea of a 'Free' Trade Zone became meaningful. As the name itself suggests, the concept of a free trade zone refers to the construction of a zone through an enclave of policies designed to assist trans-national free trade and manufacturing activities with the assistance of investments.

These investments can be private or public, domestic or foreign. However, preference is given to foreign investments. For attracting investments, a number of concessions and incentives are provided by the Government applicable only in that particular region. Consequently, the prevalent rules, practices and economic norms applicable throughout the country do not hold any validity in the free trade zone. It is because of this, that the zone is often termed as an 'enclave' or 'closed society' created by policies. Through these demarcated trade zones within the territory of a country, two important objectives are rendered. On one hand, the Government succeeds in building 'growth centers' meant

¹See Sit, Victor F.S. 1988. 'China's Export – Oriented Open Areas: The Export Processing Zone Concept', *Asian Survey*, Vol. 28, No. 6.(June), pp. 661-675.

to augment the economy and on the other hand it reaps the benefits of an open economy, within that specific region without disturbing the status quo.

The manifestation of this idea has been in various forms: Free Trade Zones (FTZ), Export Processing Zones (EPZ), Export Oriented Units (EOUs), Export Processing Factory (EPF), Custom Bonded Factory (CBF) and Special Economic Zones (SEZ) etc. They present variations depending on the requirements and political-economic environment of different countries. Infact, a difference can be seen even in the application of a single concept say EPZ in different countries. However, the fundamental principle of existence is the same in all the concepts. They are predominantly export-oriented growth strategies meant to promote industrialization.

Free trade zones can be dated back to Roman times.² They were established on major trade routes to allow international shipment, storage and export of goods. No custom duties and tariffs were imposed on such transactions. In contemporary times, various Free Trade Zones were present in United States since 1930s.³ However, many argue that Puerto Rico was the first semi-autonomous territory to experiment with this idea in 1947.⁴ To aid the region's poor economic conditions, the government decided to attract firms from Mainland US to invest. In 1951, the statutory body also passed tax exemption law to attract and provide incentive to foreign and mainland investors.⁵ Soon many countries followed the lead. In early 1960s, Ireland set up the first EPZ in Shannon, followed by Taiwan (Export Processing Zones Administration in Kaohsiung) and India (KAFTZ in Gujarat) in 1965.

² Kreider, L.E. 1975. 'Free Port', *Encyclopedia Americana*, pp. 43-44.

³ Wang, Jici & Bradbury, John H. 1968. 'Changing Industrial Geography of the Chinas Special Economic Zones', *Economic Geography*, Vol. 62, No. 4, (Oct.), p 309.

⁴ 'India SEZ Summit 2006: Driving Investments and Exports: Building Growth Centres', Confederation of Indian Industries, New Delhi, Website: http://cii.in/documents/WTO/SEZ_Background_Paper.pdf, date of access: 1/01/2008, pp.10. Also see Bolin, Richard L. 'Editorial: What Puerto Rico Face in Being First to Create EPZs in 1947...and its huge Success', Website: <http://explorersfoundation.org/archive/409t1-english.pdf>, date of access: 1/01/2008.

⁵ Ibid.

In 1970s and 1980s, this process continued and a large number of Zones were set up in Mexico, Korea, Singapore, Dubai, Malaysia, UAE, and China. The idea of establishing 'growth centers' was so successful that soon EPZs, SEZs, and EPFs proliferated throughout Asia and the Pacific, the Middle East, Africa, Latin America and the Caribbean'.⁶ At present according to World Export Processing Zones Association, there are more than 1000 zones across the globe.⁷

To understand the concept of SEZ, it is important to know the versions that existed earlier viz. FTZ and EPZ among others. However, this is not to say that the latter has led to the formation of SEZs or that SEZs have come into existence after these zones in a sequence. Rather it is the diversification of an idea as an export oriented growth strategy. **Free Trade Zone** is an area where all import and export barriers (in the form of tariffs and quotas) and bureaucratic hassles are relaxed or removed. That is, a free trade zone is

*'...an isolated, enclosed and policed area, in or adjacent to a port of entry, without resident population, furnished with the necessary facilities for lading and unloading, for supplying fuel and ships' stores, for storing goods and for reshipping them by land and water, and area within which goods may be landed, stored, mixed, blended, repacked, manufactured, and reshipped without payment of duties and without the intervention of customs officials.'*⁸

The simplest form of free trade zone concept is Custom-Bonded Warehouses (CBW) and Customs Bonded Factories (CBF). These 'are found in a number of Asian countries and are usually in operation when a country is not yet ready to adopt the more organized enclave type EPZ system for example due to inadequate provision of infrastructure and public utilities, lack of managerial or planning staff'.⁹

⁶ See Amirahmadi, Hooshang and Weiping Wu .1995. 'Export Processing Zones in Asia', *Asian Survey*, Vol. 35, No.9. (Sep.), pp. 828-849.

⁷ As quoted in 'India SEZ Summit 2006: Driving Investments and Exports: Building Growth Centres', Confederation of Indian Industries, New Delhi, Website: http://cii.in/documents/WTO/SEZ_Background_Paper.pdf, date of access: 1/01/2008

⁸ Thoman, R.S. 1956. *Free Ports and Foreign Trade Zones*, Cambridge: Cornell Maritime Press, p.7.

⁹ Wong, Kwan- Yiu, and Chu, David K.Y. 1984. 'Export Processing Zones and Special Economic Zones as Generators of Economic Development: The Asian Experience', *Geografiska Annaler. Series B, Human Geography*, Vol. 66, No.1, p. 14.

The innovation and variation of this idea is seen in the form of **Export Processing Zones**. Decolonization that took place after World War II, left the colonies with underdeveloped and poor economies and technical expertise. Hence, they aimed at bringing foreign capital and advanced technology to develop their region in return of land, material and labor resources. In this context, the idea of EPZ was successfully implemented in East and South East Asia especially in Taiwan and South Korea. With passage of time, the World Bank also proposed this policy to various Third World Countries for example Bangladesh¹⁰. According to the World Bank, EPZs could prove to be a vital alternative strategy for growth in developing countries, which followed inward looking policy for decades and were not able to solve the fundamental problems such as poor economic growth and unemployment.

The birth of EPZs over FTZs was to provide incentives specifically to export oriented industries. Further, Export Processing Zones are offshoots of FTZs in the sense that the zones have additional processing, assembly or manufacturing activities.¹¹ That is, FTZs are accompanied with manufacturing activities and built in infrastructure. However, export processing and free trade zones are combined in the same industrial estate and thus the terms are often used interchangeably. According to United Nations Industrial Development Organization (UNIDO), Export Processing Zones are defined as areas involved in the “establishment of modern manufacturing plants inside an industrial estate, by offering suitable package of investment incentives to both foreign and domestic entrepreneurs.”¹² Based on the above we can delineate three important characteristics of EPZ, also found in SEZs¹³.

¹⁰ See Dowla, Asif. 1997. 'Reprocessing Zones in Bangladesh: The Economic Impact', *Asian Survey*, Vol.37, No.6, (June), pp.561-574.

¹¹ Kundra, Ashok .2000. *The Performance of India's Export Zones: A Comparison with the Chinese Approach*, New Delhi: Sage Publications, p. 24.

¹² As quoted by Vittal, N. 1977. *Export Processing Zones in Asia: Some Dimensions*, Tokyo: Asian Productivity Organization, p.122.

¹³ See, Kundra, Ashok .2000. *The Performance of India's Export Zones: A Comparison with the Chinese Approach*, New Delhi: Sage Publications, p. 24.

- That, it is a *duty free area* where import of capital goods and raw material is allowed. In addition, since these areas are segregated from domestic custom regime the operational procedures are easier.
- It is an *industrial estate*, which provides industrial sites, facilities and special infrastructure that are usually not allowed outside.
- It provides a *package of incentives* including a tax holiday for a specific period.

The Concept of Special Economic Zones

The concept of 'Special Economic Zones' is not very different from that of FTZs or EPZs. SEZ was the brainchild of Chinese Government. It was first introduced in 1979 in four Chinese cities viz. Shenzhen, Zhuhai and Shantou in Guangdong province and Xiamen in Fujian province. SEZ was introduced as an improvement over the earlier existing concepts with minor variations. While the package of incentives, free trade and easier operational procedures remained more or less the same, the difference was only in the kind of economic activities an SEZ unit allowed. Unlike EPZ where only export industries are encouraged, SEZs permits a wide range of economic activities. In this sense, SEZs can contribute in the economic makeover of the entire region.

The crux of an SEZ approach is to carve out an area of the country and exempt it from certain local policies so that investment climate compatible with the growth of viable range of economic activities may be developed. In this context, an SEZ policy is made of following three elements¹⁴:

- **Macro Climate:** refers to range of comparative advantages a country can offer to the investors. For example, the cheap labor India can offer in comparison to America.
- **Meso Climate:** Refers to the measures that restrict and restrain national policies and practices that would deter the development of economic activities in that particular region.

¹⁴ See Sit, Victor F.S. 1988. 'China's Export – Oriented Open Areas: The Export Processing Zone Concept', *Asian Survey*, Vol. 28, No. 6, (June), pp. 661-675.

- **Micro Climate:** These relate to suitable sites, infrastructure and incentive packages offered by the host country.

These three – Macro, Meso and Micro elements make the zones ‘Special’. Further, they are given the nomenclature of ‘Economic’ because of the array of activities they permit. Not just the export industries but the special economic zones are interested in developing practically all items of industries, agriculture and allied activities, tourism, housing and construction, research and manufacturing involving high technology and techniques and other trades of common interest to investors and to the government.¹⁵ That is an SEZ aims to build an integrated and fully equipped township while an Export Processing Zone is a dedicated area for intensive industrial activity.

Following the above, an attempt is made to understand SEZs in the Indian context. (Please refer to the fact-sheet on the Indian SEZs, in the Annexure -A, for a profile overview). Government of India, defines SEZ as ‘a specially delineated duty free enclave and shall be deemed foreign territory for the purposes of trade operations and duties and tariffs’.¹⁶ It is deemed as a piece of foreign territory because of two reasons: firstly, unlike the Domestic Tariffs area (or the economic policies followed in rest of the Indian territory) principles of open market applies in this region. Second, there are no foreign ownership restrictions in developing zone infrastructure.¹⁷ Government of India has made SEZ as an enclave through a number of provisions and policies applicable only in that region. These can be categorized into four groups:

- **Preferential Treatment:** these include a number of customs and excise, income, sales and service tax discounts given by both the Centre and the state governments. These discounts are given to the Unit as well as and to the developer.
- **Freedom to the investors**
- **Administration:** refers to the provision which make the operational procedures easier

¹⁵ See ‘List and type of SEZ notified’, Website: <http://sezindia.nic.in/welcome.htm>, date of access: 21/01/08.

¹⁶ ‘FAQ’, Website: <http://sezindia.nic.in/welcome.htm> , date of access: 10/11/07.

¹⁷ However, the Government will retain the statutory functions.

- Local advantages and provisions.

(Please refer to Annexure – B, for a complete list of incentives and concessions given to the investors.)

To facilitate further understanding of SEZs, it is important to differentiate it from EPZs. SEZs and EPZs are identical in number of ways for instance, the incentives given, the easier operational procedures and objectives of earning foreign exchange and attracting investments. However, there are certain differences between the two that make SEZs more conducive to the Indian Economy. EPZs, from policy perspective are short lived as it aims only in developing export oriented industries. SEZs, however aims to bring regional development, technological up-gradation and provides employment and therefore contributes to the overall development of the area. In this sense, it has a long-term objective.

Secondly, EPZs mainly provide infrastructure specific to industrial estates. On the contrary, SEZ provides both supportive infrastructure, like housing, airports, roads etc., as well as services like power, telecommunication, and transportation. Thirdly, EPZs mainly focus on industries. SEZs have a wider scope as they engage not only in industries but also in agriculture, commerce, tourism, and other services. Lastly, EPZs are mostly insulated in enclaves whereas SEZs have much stronger forward and backward linkage with domestic economy. The Ministry of Commerce and Industry has listed many technical differences in the operation of the both SEZs and EPZs. Refer to annexure - C to see the list of differences between EPZs and SEZs.

Evolution of the Policy:

Special Economic Zones did not come into existence unpredictably. The need for such a policy was created right from 1960s. The study of the founding years can help elucidate the rationale for the establishment of such a policy and help in its critical examination undertaken in Chapter 4 and 5. Following phases describes policy evolution in India:

Upto 2001:

a) 1950s – 1980s: The Committee on ‘Export Strategy for 1980s’ also known as Tandon Committee, established by government of India in 1974 gives a very clear picture of why India felt the need for an export led growth strategy.¹⁸ As already mentioned, at the time of independence, the two most important considerations were maintaining political and economic sovereignty and to ensure social justice. Adopting a free market economy could negate both the objectives. Therefore, India embraced democratic socialism as the ideology to govern the Indian society. Need for a growth strategy that could fit into this framework of democratic socialism was felt. Concurrently, according to the Tandon committee, two forces compelled Indian planning and development. On one hand, India had to import almost all manufacturing goods through large sums of foreign exchange. On the other hand, it was able to export only primary goods and even these were subject to violent swings in the global economy. This led to low reserves of foreign exchange needed for growth and consumption, and foreign debt. Economist feared that this could result in continued foreign domination. Hence, a closed-door policy was adopted to break this dependence. Since dependence appeared to rest on a continual lack of foreign exchange and the need to import all manufactured goods, an import-substitution industrialization strategy, it was felt, would lead to replacement of these imports by domestic production.¹⁹

However, since majority of the population had low purchasing power they failed to provide a market for domestically produced manufactured goods. Further, due to the protectionist policy followed by the government the production was of high cost, inefficient and a waste of capital resources. Strict licensing policy bred monopoly of producers. At the same time, lack of capital, low technological level and little access to international markets invariably led to dependence on foreign assistance. India’s balance of payment deficit continued. Hence, since the second plan the emphasis shifted to exports. This policy was ‘in part at least the result of the pressure from international

¹⁸ See *Committee on Export Strategy for 1980s, Final Report (Tandon Committee)*, Ministry of Commerce, Government of India, 1980, New Delhi.

¹⁹ Rai, Anil. 1981. ‘Review: Export Strategy; Reviewed Work(s): Committee on Export Strategy for 1980s, Final Report (Tandon Committee)’, *Social Scientist*, Vol. 9, No. 12. (Dec.), pp. 77-78

capital and such international agencies as the International Bank for Reconstruction and Development and IMF'.²⁰ However, there was a difference experienced this time. In past export- led strategy concentrated on primary goods but with increasing division of labor, production and export of manufacturing goods came to be emphasized. This was because, it was realized that developing countries could provide an ideal location for labor-intensive industries due to the comparative advantage of low labor cost.

Some incentive schemes to promote exports were introduced during sixties but it was of no avail. Licensing, quantitative restrictions, tariffs, corruption and inefficiency crippled the growth of exports. In this background, the policy of Export Processing Zones became attractive to the government official. This is because for three reasons:

- a) it was envisaged as a strategy that would attract foreign investments, earn foreign exchange, generate employment, facilitate the transfer of technology, provide backward and forward linkages, ensure employment and upgrades the labor skills,
- b) EPZs could act like a laboratory for testing reforms in certain pockets without exposing the whole country
- c) EPZ succeeded in providing a gateway between liberal and protectionist regime. This was important, as India did not favor adopting a liberal trade regime.

Hence, in 1965, India became the first Asian country to set up Export Processing Zones in Kandla Gujarat (KAFTZ) and Santacruz Electronics EPZ (SEEPZ) in Mumbai in 1974. Interestingly the proposal to set up Kandla EPZ, was mooted right in 1961 when the economy was highly regulated. EPZs aimed to bring regional development in the backward area of Kutch through fuller utilizations of resources and creation of additional employment. The EPZ at Mumbai was proposed for processing of electronic goods keeping in view their rapid growth in the world trade. Like KAFTZ, it was expected to increase employment opportunities and to bring in the technical knowledge. Thereafter, four more zones were set up at Noida (UP), Falta (West Bengal), Cochin (Kerala), Chennai (Tamil Nadu) in 1984 and at Vishakapatnam (Andhra Pradesh) in 1989.²¹

²⁰ Ibid, p. 78.

²¹ See website: [http://www.cbec.gov.in/customs/cs-manual/manual_22\(c\).htm](http://www.cbec.gov.in/customs/cs-manual/manual_22(c).htm), date of access: 02/01/08.

However, there were certain glaring problems with the EPZ policy²². It lacked a clear objective; it had centralized management and did not aim at forging backward or forward linkages. The most important was the bereft political commitment and administrative support, which hampered the growth of EPZs. Hence, the policy of EPZ failed to bring any positive effect in the down sliding economy. At the same time, the import-substitution industrialization strategy followed in rest of the country did not succeed in augmenting the economy. By end of 1980s, Indian polity was submerged with number of problems: 1) greater starvation for the majority of the people, 2) limited industrialization, 3) growing regional inequalities and 4) large deficits and debt.²³

b) 1980s to 1991: The policy regime remained virtually static until the mid 1980s, since there was no change in the macro economic policies that were followed. Tandon Committee aptly summed up that administration showed lack of emotional adjustment to the permissiveness needed in an over planned and controlled industrial environment. This was also the main reason why the policy of EPZs did not achieve its set targets. The policy relating to EPZs were rigid and restrictive and the package of incentives and facilities was not attractive. Customs procedures for bonding, furnishing bank guarantees and movement of goods acted harshly at the operational level.²⁴ Consequently, the growth of EPZs was slow during this period and their contribution to exports was not significant.²⁵ However, in the later part of 1980s the need to emphasize foreign trade became obvious with the huge fiscal deficit created due to the lopsided production for domestic market. A strategy was needed that would establish balance of production for both domestic and foreign market. Based on the suggestions received from Trade and Industry, and the recommendations of Indian Institute of Foreign Trade some favorable policy measures were introduced, during this period. However, major changes were made only in the subsequent years.

²² See, Kundra, Ashok .2000. *The Performance of India's Export Zones: A Comparison with the Chinese Approach*, New Delhi: Sage Publications, p. 24.

²³ See *Committee on Export Strategy for 1980s, Final Report (Tandon Committee)*, Ministry of Commerce, Government of India, 1980, New Delhi.

²⁴ Kundra, Ashok .2000. *The Performance of India's Export Zones: A Comparison with the Chinese Approach*, New Delhi: Sage Publications, p. 43.

²⁵ *Ibid*, p. 44

c) 1991 -2001: In the wake of foreign exchange crisis, wide ranging measures were initiated for revamping and restructuring the economic policies. The major initiatives taken were that of structural adjustment programme, drastic reduction of regulations and control, de-bureaucratization and introduction of market mechanism. Hence, a five-year Exim policy (1992 to 1997) was formulated in 1992, which aimed at integrating the Indian Economy with the rest of the world by curtailing licensing, quantitative distinctions and discretionary controls, and lessening administrative controls.²⁶ This policy acknowledged the crucial role State Governments had to play in export promotion. This was because in mid 1991, when new economic policies were initiated an area of concern which emerged was the fiscal relationship between the centre and the state. It became extremely clear that urgent measures were needed to help the states recover from the fiscal crisis and make them less depended on resources transferred from the centre.

In this background, a re-emphasis on export zones was seen and in 1997, Surat Export Processing Zone was established. Due to the limited success of export processing zones, a make over of this policy was needed. Therefore, efforts were made to enhance decentralization, provide additional fiscal incentive and facilities, and simplify the policy provisions and customs regulations within the existing EPZ policy. However, these were not sufficient and a new strategy of similar nature was sort. China that experienced a great success with the growth and development of special economic zones became the ready source of reference. Few modifications of the existing EPZ policy with tested ideas drawn from Chinese model led to creation of the SEZ policy.

2001 Onwards:

The Exim policy for 1997-2002 took the process of liberalization further.²⁷ In 2000, Murasoli Maran, the then Union Minister of Commerce and Industry gave guidelines for incorporating SEZ into the 1997-2002 EXIM policy frameworks. In April 2002, he announced a policy statement for SEZ. At this point, no Act was proposed in the

²⁶ Ibid, p. 39.

²⁷ 'Exim Policy 1997-2002', Press Information Bureau, Government of India, Website: http://pib.nic.in/archieve/eximpol/eximpolicy2002/eximpolicy2002_rel.html#2, date of access: 02/01/08.

Parliament for establishment of Special Economic Zones. They were operated through Export- Import policies that earlier governed EPZs. The export- import policies largely depended on the ideological inclination and political compulsions of the ruling party. Therefore, the SEZ policy decision was not only driven by the need for providing an internationally competitive environment for exports and earning foreign exchange. It was also the compulsion of maintaining a coalition. The NDA (National Democratic Alliance) government came to power in 1999, with the help of thirteen regional and state based party allies. Consequently, the regional and state based parties attempted to gain maximum benefit from the centre. This led to recognition of the 'states' in having a greater say in decision making and their demand for fiscal autonomy gained more impetus. The introduction of the SEZ policy was a symptom of the same transformation, taking place in the Indian political scenario.

During this period, thirteen functioning SEZ were established. That is, in principle approvals had been given to setting up of 13 new SEZs (state government/private sector) at Nanguneri (Tamil Nadu), Dronagiri (Maharashtra), Paradeep (Orissa), Gopalpur (Orissa), Kulpi (West Bengal), Bhadohi (UP), Kanpur (UP), Kakinada (Andhra Pradesh) Indore (MP), Grater Noida (UP), Salt Lake (West Bengal), Hassan (Karnataka) and Positra (Gujarat).²⁸ Besides these, all other EPZs in Kandla (Gujarat), SEEPZ (Mumbai), Cochin (Kerala), Surat (Gujarat), Noida (UP), Chennai (TN), Vizag (AP), Falta (WB) were converted into SEZs.

The UPA government came to power in 2003 and had many concerns, which could be seen as a foreground for furthering policies like SEZ. The first concern relates to their political stand, which comes out clearly in congress' National Common Minimum Programme. The UPA government, aimed to bolster the process of decentralizing by giving more powers and functions to the states to manage their own affairs. Second concern related to their economic ambition of ensuring 9% of economic growth, which would not be possible without an emphasis on export promotion and greater role for states. The last concern was about the performance of EPZ/ SEZ.

²⁸ ibid

The UPA government felt that the existing system relating to SEZs did not inspire enough confidence in the investors to commit a substantial amount of money for the development of the same²⁹. In 2003, the ratio of foreign direct investment to total investment in Indian Export Processing Zones was less than 25%, as compared to a figure of over 80% in similar zones in Bangladesh and Sri Lanka in the same year³⁰. This was because of various problems like; lack of stable policy and proper legislation, absence of sufficient tax benefits and inability to resolve several state level issues by the centre etc.

To provide a long-term stable policy framework with a minimum regulatory regime and to provide expeditious clearance, it became necessary to bring a Central Government Act for SEZ, which would be in line with the international practices. Hence, in May 2005, SEZ Act was passed by the Parliament and on 23rd June it received Presidential assent. (Refer to the annexure – D, for the main clauses of the SEZ Act, 2005). By February 2006, the rules of the Act were notified. Later a number of Amendment Acts were passed as mentioned below:

- SEZ Rules, 2006 - Amendment No. 1, dated 10th August 2006
- SEZ Rules, 2006 - Amendment No.2, dated 16th March 2007
- SEZ Rules, 2006 - Amendment No.3, dated 12th October 2007

At present (as on 19/02/08), there are 439 formally approved SEZs, 138 in- principle approved SEZs, 195 notified SEZs and 19 operational SEZs. Through 'this policy' it is 'intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations'.³¹

²⁹ See, Mukherji, Rahul & Apama Shivpuri Singh. 2006. "Investing in the Indian Special Economic Zones: A Background Paper" at the Institute of South Asian Studies, National University of Singapore, 30 May, Website: www.isas.nus.edu.org, date of access: 23/10/06.

³⁰ Ibid

³¹ 'Background note Special Economic Zones in India', Website: <http://www.sezindia.nic.in/HTMLS/about.htm>, date of access: 01/09/07.

Characteristics of Indian SEZs

As already mentioned the nature of a Zone can vary according to the context and requirements of a country. Below is an attempt to bring out characteristics that are specific to Indian Special Economic Zones. These would not only help in differentiating Indian SEZs with those around the global but will also help in bringing out the specific impact of the policy undertaken in chapter 5. -

Size:

The basic idea is to allow sufficient space so that the economic activities can be carried out. As the EPZs of Asian nations are basically the outcome of a strategy for industrial development with foreign participation being involved primarily in manufacturing production, the areas of these 'industrial estates' need not be exceedingly large.³² Hence, we notice that EPZs are confined only to 345 hectares in Bataan, Philippines, 202 in Kantunayake, Sri Lanka and 284 hectares in the earlier established EPZ in Kandla Gujarat. These predominantly focus on private participation. These zones do not have any resident population. 133 countries have adopted the small area zone concept.³³

We find contrary cases in China. The Chinese motive was to build SEZs as a laboratory for testing reforms. Further, through SEZs, it was aimed to ensure comprehensive development of the region. Therefore, the Chinese SEZs had a large area size. Further, since China wanted to keep SEZs largely in governmental domain they were more open to the idea of large-scale economic zones. For instance, the Shenzhen SEZ has an area of 32,750 hectares. Other notable examples are in Russia, Brazil and Singapore.

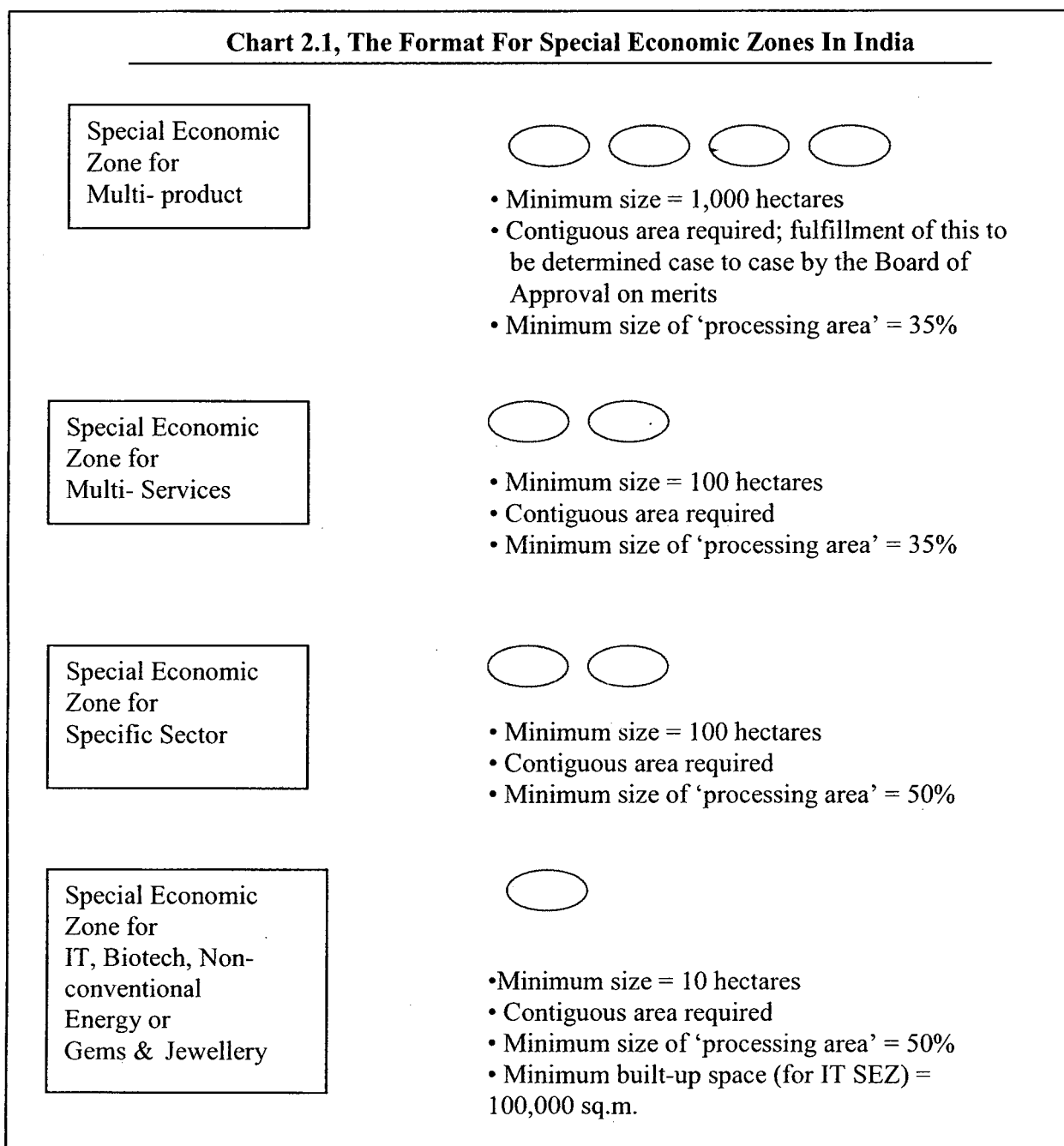
Since the main aim of the Indian SEZs is to attract maximum foreign investment and provide greater flexibility to the investors, it has experimented with both large and small

³² Wong, Kwan- Yiu, and Chu, David K.Y. 1984. 'Export Processing Zones and Special Economic Zones as Generators of Economic Development: The Asian Experience', *Geografiska Annaler. Series B, Human Geography*, Vol. 66, No.1, p. 3.

³³ 'India SEZ Summit 2006: Driving Investments and Exports: Building Growth Centres', Confederation of Indian Industries, New Delhi, Website: http://cii.in/documents/WTO/SEZ_Background_Paper.pdf, date of access: 1/01/2008, p. 6.

size of SEZs. The size of an Indian SEZ can vary from 10 hectares to 1,000 hectares. This size will vary according to the type of production or the specific sector it caters.³⁴

Chart 2.1 below, gives the size specification for various types of SEZ Units:



Source: http://cii.in/documents/WTO/SEZ_Background_Paper.pdf, date of access: 01/01/08

³⁴ See, 2006. 'Empowered Gom Resolves SEZ Issues – Significant Inflow Of investment In Zones Expected, Says Kamal Nath', Press Information Bureau, Government of India, Website: <http://www.pib.nic.in/release/release.asp?relid=18238>, Date of access: 01/01/08.

Physical Manifestation:

The SEZ unit is divided into two parts- processing and non- processing area. The Development Commissioner of the SEZ would demarcate these areas.³⁵ Within the processing area, the manufacturing activities would take place. For the same, the land can be leased:

- to entrepreneurs holding valid letter of approval
- For providing facilities exclusively within the units such as cantēens, public telephone booths, first aid canthers, crēches etc.
- To a person who desires to build infrastructural facilities within the prospective Units.

Facilities like Free trade and Warehousing Zones (FTWZ) and International Financial Service Centre (IFSC) may be provided. The Developer of the SEZ can allot land within the non-processing area for various businesses and social purposes like³⁶:

- Educational institutions,
- Hospitals,
- Hotels
- Recreational and entertainment facilities
- Residential and business complexes.

Domestic tariff area units are not allowed to set up any establishments in the processing or non-processing zone. Further, Government has specified minimum land use criteria within the SEZ as given in the table 2.1 on the next page: -

³⁵ They would be separated by a boundary wall of specified construction ie. 2.4 m height above plinth level and then surrounded with 0.6 m high barbed fencing. They would be connected through an Entry- Exit point.

³⁶ 'India SEZ Summit 2006: Driving Investments and Exports: Building Growth Centres', Confederation of Indian Industries, New Delhi, Website: http://cii.in/documents/WTO/SEZ_Background_Paper.pdf , date of access: 1/01/2008, p. 16.

Table 2.1, Minimum land Use Criteria within the SEZ Unit

Land Use	% Area of Allocation
Residential	35-40%
Commercial	4-5%
Industrial	10-12%
Recreational	18-20%
Public and semi-public	12-14%
Transportation	12-14%
Agriculture and water bodies	Balance
Total	100%

Source: 'Note on special economic zones', confederation of Indian Industries, International Trade Division, website: <http://cii.in/documents/WTO/Note%20on%20Special%20Economic%20Zones-1.pdf>, date of access: 01/01/08.

Location:

Location plays a very important role in determining the nature and quantity of investment. In the past, sites for export processing zones have primarily depended upon the accessibility to the area, through water and / or air and / or road. For example, EPZs established near ports are Masan and Iri free export zones in Republic of Korea. Zone, which depends mainly on Air transportation, is Baguio EPZ in Philippines. Of late, new arguments, regarding the location of the zones have come up. Many argue that the zone should be established near developed pockets of the country so that well-established infrastructure and services required to operate can be readily accessed. Others argue that they should be established in backward region so that economic upliftment of these regions through the unit is possible. For instance, Philippines' five-year plan aimed to disperse new industries to various regions in order to achieve a better balance of economic opportunities and more equitable income distribution.³⁷

³⁷ Gonzaga, Leo . 1977. 'Philippine Planners at work', *Far Eastern Economic Review*, August 5, p 39.

In India there are no specific restrictions relating to establishment of SEZ. Examples of SEZ sites located near easily accessible areas (Santacruz Electronics in Mumbai), near developed areas (Noida Special Economic Zone) and to far off regions (Medicaps IT Park Private Limited, M.P.) can be found. However, State governments can bring in necessary regulations to monitor the location of SEZs. For instance, Haryana government claims that it is important for the State Government to ensure development of the industrially backward regions of the State. Therefore the State Government may assist the private sector in developing not more than 5– 6 Multi product SEZs in the NCR (National Capital Region). Further, the State Government will endeavor to ensure dispersal of these SEZs, even within the NCR. Similarly, not more than two Industrial Model Town Ships would be encouraged in the NCR.³⁸ (Refer to the annexure- E for state-wise distribution of SEZs).

Financial Participation:

In order to facilitate investments in the SEZs established in the host country various forms of financial participation have been designed. They can be of different nature, ranging from sole proprietorship to joint venture to co-operative production, intermediate processing and compensation trade. The Government can also play different roles in the financial agreement with the domestic or foreign investors. SEZs in India can be established through various types of financial partnership. A Special Economic Zone may be established, jointly or severally by the Central, State or by any person for manufacture of goods or rendering services or for both or as a Free Trade and Warehousing Zone.³⁹ Consequently, the operation and maintenance of SEZs is privatized except in those cases where SEZs are established by Centre and/or state governments. In the former only statutory functions are controlled by the Government.⁴⁰

³⁸ See, Website: www.haryana.gov.in/Policy_of_SEZ.pdf, date of access: 21/01/08.

³⁹ 'Chapter 2: Establishment of Special Economic Zone', *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/ Asadha 2, 1927 (saka), pp. 5.

⁴⁰ See, 'FAQs', Website: www.sezindia.nic.in, date of Access: 5/06/06.

Role:

Export Zones are classified based on the role they play in different countries. According to V. Sit, EPZs can be of two types: EPZ I and EPZ II.⁴¹ EPZ type - I is found in those countries that already have reasonable conditions for promotion of export industries. These EPZs therefore, become a transient phenomenon and its significance as a 'special' policy diminishes with the overall advancement in the country's development of export-oriented industries. The EPZ type - I is found in Taiwan. The creation of special policy enclaves in Kaohsiung, Taichung and Tainan, became a precondition for development of viable export industries in Taiwan. With the rapid expansion of its exporting sector since then and the gradual creation of numerous well-planned industrial areas and districts throughout the island, the significance of the EPZs in Taiwan's overall export economy has declined.⁴²

EPZ type- II on the contrary, is found in those countries that subscribe to the strategy of import substitution and lack conditions for internationally competitive industries. EPZ type- II plays a complementary role in maintaining status quo industrialization strategy and persists over a long period. Examples are Malaysia and Thailand. At present, it is difficult to classify the zones being established in India as they are in a nascent stage. However, it can be observed that the Indian government in 1960s established type II-EPZs. Their aim was to bolster exports in a country propelled by import-substitution policy. However, the case of SEZ is different. With these enclaves, the government intends to fillip the entire manufacturing sector and eventually open the entire economy. Hence, they seem to resemble type I.

Focus area:

Zones established worldwide are either industry specific or performance specific. Industry specific zones focus on developing the competitiveness of particular industries in the global markets. These industries can range from banking to jewellery, oil and gas, electronics, textiles, IT, tourism or can even be multi product SEZs. (Please refer to the

⁴¹ See Sit, Victor F.S. 1988. 'China's Export - Oriented Open Areas: The Export Processing Zone Concept', *Asian Survey*, Vol. 28, No. 6, (June), pp. 661-675.

⁴² Ibid, p. 68.

Annexure- F, for Sector wise distribution of SEZs). 17 countries have experimented with industry specific zone concept including USA, Taiwan, Japan, Hong-Kong, France and Germany.⁴³ Performance specific zones give more emphasis to meeting the performance benchmark. Developers that meet certain performance criteria e.g. size of export, level of technology, specific amount of investment are admitted in the zone. Only four countries have adopted performance specific zone concept including Mexico and Mauritius.⁴⁴ India has experimented with both the type of zones.

Categorization of SEZs:

The process of establishing SEZs is only two years old and hence different categories of SEZs are noticed. They are as follows:

- Those converted from EPZs to SEZs
- Functioning: refers to those SEZs that are in operation.
- Approved: refers to those SEZs, which have been granted approval by the government and have acquired land required to set up SEZs.
- Approved in principle: refers to those SEZs, which have been granted approval by the government but still are in the process of acquiring land.
- Pending approval: refers to those proposals for establishing SEZs that are in the process of gaining approval from the BOA.
- Rejected: These are proposals of establishing SEZs that were rejected.
- Under-construction
- Scrapped: At present, there are no SEZs that have been scrapped after the approval has been granted for their establishment. However, based on the Goa regional Plan 2010, there has been a strong demand by the Goa state government to scrap the three SEZs, established within the state. Centre government though is firm on not scrapping SEZs within Goa⁴⁵.

⁴³ 'India SEZ Summit 2006: Driving Investments and Exports: Building Growth Centres', Confederation of Indian Industries, New Delhi, Website: http://cii.in/documents/WTO/SEZ_Background_Paper.pdf, date of access: 1/01/2008, p. 6.

⁴⁴ Ibid, p. 6.

⁴⁵ 'Centre Firm on not Scrapping Goa SEZs', *Business Standard*, 5th June.

The Special Economic Zones Act, 2005

As already mentioned, EPZ was the earliest manifestation of the idea of SEZ in India. EPZ established in 1960s had no legislative cover and was administered by the then EXIM policy. The subsequent initiative was taken by the NDA government in 2000, by incorporating the guidelines for establishing SEZs in the EXIM policy for 1997-2002. However, no legislation act was enacted by the government and the SEZs were governed by EXIM policy dependent on the ideological inclination of the party in power. For the first time through the SEZ Act 2005, the UPA government gave a concrete framework for establishing, implementing and governing SEZs. What follows is the discussion of the legislative institutional cover provided by this Act. (For further reference, see the Act attached as annexure D).

Board of Approval

This Board is the highest authority in the SEZ institutional framework. Located in the Ministry of Commerce and Industry, its main aim is to review the proposals for setting up SEZs.

Composition:

The Board of Approval (BOA) consists of large number of members. A Chairperson who is of the rank of an Additional Secretary in the Ministry of Commerce and Industry (MOCI) heads it. Eighteen or more members follow him. Thirteen out of them are of the rank of Joint Secretary or higher in the Central Government. Two officers out of 13 deal with revenue, one with economic affairs and the rest deal with commerce, industrial policy and promotion, science and technology, small scale industries and agro and rural industries, home affairs, defence, environment and forests, law, overseas Indian affairs and urban development. The Central government nominates all thirteen members. Remaining five members or more members are:

- One nominee of the State government,
- One member who is the Director General of Foreign Trade,
- The Development Commissioner concerned

- A Professor from the Indian Institute of Management,
- A Deputy Secretary dealing with the Special Economic Zones in the Ministry or Department of the Central Government, dealing nominated by the Central Government,
- For performing the functions of BOA, the Board can co-opt members who possess either specialized knowledge or experience to help in the various activities of SEZs.

*Powers, Duties and Functions:*⁴⁶

BOA housed within Ministry of Commerce and Industry (MOCI) has wide-ranging powers. However, any decision of the Central government relating to SEZs would be final and binding. The powers and functions are as follows:

- To promote and ensure orderly development of the Special Economic Zones
- Granting, rejecting or modifying proposals for establishing of the Special Economic Zones
- granting approval for authorized operations in the Special Economic Zones by the Developer
- granting of approval to the Developers or Units for foreign collaborations and foreign direct investments in the Special Economic Zone for its development, operation and maintenance
- granting or rejecting of proposal for providing infrastructure facilities in a Special Economic Zone or modifying such proposals
- granting a license to an industrial undertaking
- To decide as to whether a particular activity constitutes manufacture
- To delegate powers and functions to one or more Development Commissioner for effective and proper discharge of the functions of the Board.

⁴⁶ See, 'Chapter 2: Establishment of Special Economic Zone', *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/Asadha 2, 1927 (saka), pp. 9-12.

Development Commissioner (DC)

The office of DC is very powerful. Person incharge of this office is virtually engaged in all the administrative, economic and operational activities taking place within the SEZ. Further, he provides the link between the Centre/state government and SEZ.

The Office:

Each SEZ will have one or more Development Commissioner (DC). DC would not be below the rank of Deputy Secretary and will be appointed by the Central Government (MOCI).

*Functions of DC*⁴⁷:

- Guide the entrepreneurs for setting up of Units in the Special Economic Zone
- Ensure and take suitable steps for effective promotion of exports
- Ensure proper co-ordination with the Central Government or State Government Departments concerned or agencies
- Monitor the performance of the Developer and the Units in a Special Economic Zone and ask for information which may be necessary
- Discharge other functions as may be assigned to him by the Central Government, State government or the Board
- To exercise administrative control and supervision over the officers and employees appointed.
- The Development Commissioner, may, delegate any or all of his powers or functions to any of the officers employed under him

⁴⁷ See, 'Chapter 4: Development Commissioner', *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/ Asadha 2, 1927 (saka), pp. 14-15.

Approval Committee for single window clearance

‘A single window clearance mechanism’ through an Approval Committee ‘has been operationalised to speed up the state level regulatory clearances required for investment’.⁴⁸

Composition:

This committee consists of nine permanent members. The Chairperson who is the Development Commissioner heads the committee. Two officers nominated by Central government follow him. Two other officers of the central government representing ministry or department dealing with revenue and one with economic affairs are present. Two state government nominated officers, are also present in the committee. In addition, a representative of the developer is also a part of the committee. Approval committee may also appoint persons whose can assist or advice in necessary situations.

Powers and Functions are as follows⁴⁹:

- To approve the import or procurement of goods from the Domestic Tariff Area
- To approve the providing of services by a service provider, from outside India, or from the Domestic Tariff Area
- Monitor the utilization of goods, services, warehousing or trading
- To approve, modify or reject proposals for setting up Units for manufacturing, rendering services, warehousing or trading
- To allow, on receipt of approval foreign collaborations and foreign direct investments
- To monitor and supervise compliance of conditions subject to which the letter of approval or permission, if any, is granted to the Developer or entrepreneur
- To perform other functions entrusted by the Central Government or the State

⁴⁸ Mukherji, Rahul & Aparna Shivpuri Singh. 2006. “Investing in the Indian Special Economic Zones: A Background Paper” at the Institute of South Asian Studies, National University of Singapore, 30 May, Website: www.isas.nus.edu.org (date of access: October 23, 2006) p. 14.

⁴⁹ See, ‘Chapter 5: Single Window Clearance’, *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/ Asadha 2, 1927 (saka), pp. 15-17.

Government concerned.

SEZ Authority

SEZ authority specifically looks into the functioning of the SEZs. They are, so to say the guardian of the zone.

Composition:

An SEZ Authority is to be headed by the Development Commissioner and will be responsible for governing an SEZ. The Authority will comprise of following five members:

- Two officers nominated by Central government either having knowledge or experience in dealing with matters relating to SEZ.
- One officer nominated by Central government dealing with Commerce
- Not more than two members who are either entrepreneurs or their nominee.

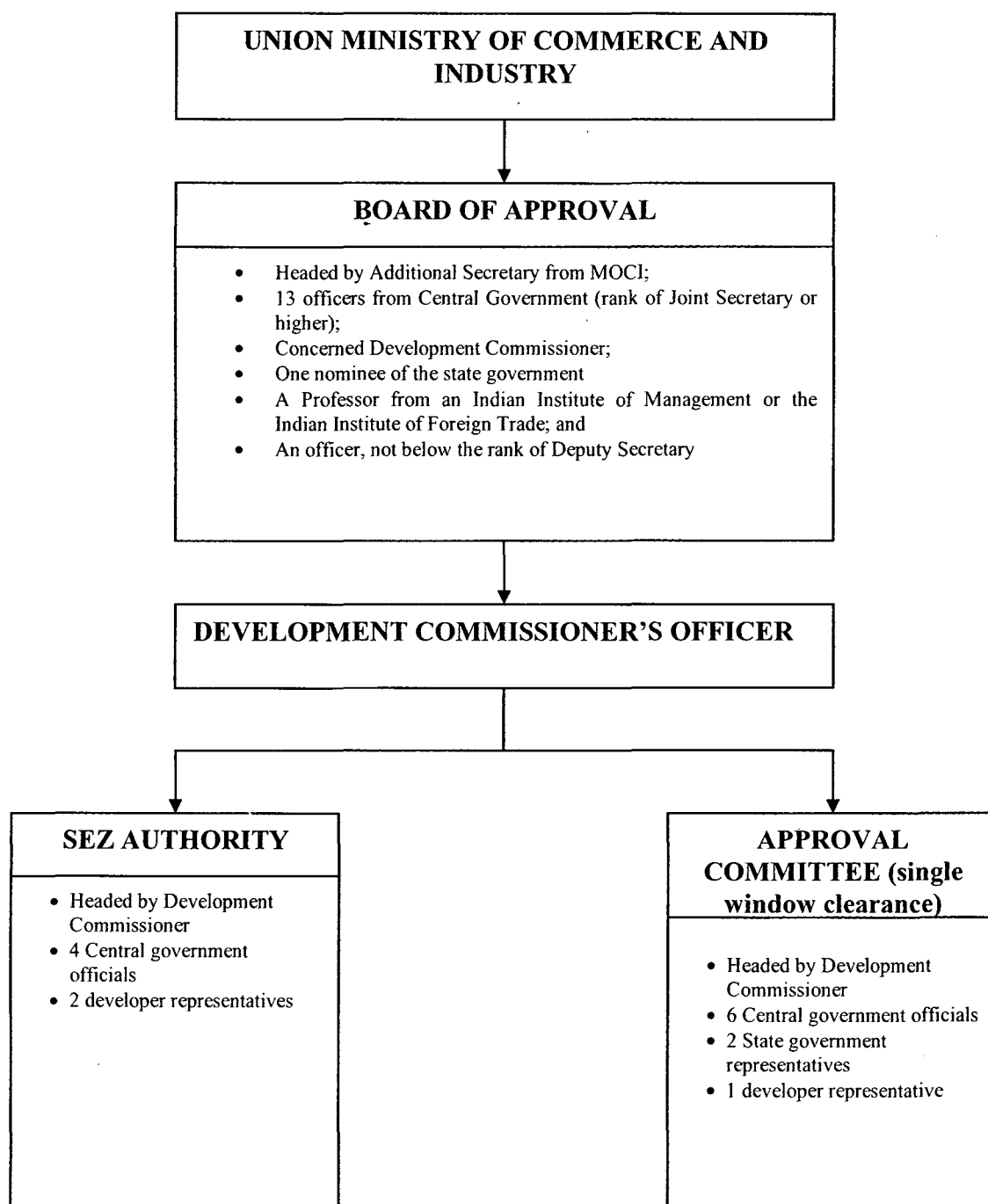
Functions⁵⁰:

- The development of infrastructure in the Special Economic Zone
- To promoting exports from the Special Economic Zone
- To review the functioning and performance of the Special Economic Zone
- To levy user or service charges or fees or rent for the use of properties belonging to the Authority.

Chart 2.2, on the next page gives the institutional structure as per the SEZ Act 2005. The duties and functions of all the four authorities – the Development Commissioner, Board of Approval, Approval Committee and the SEZ Authority, mentioned in the SEZ Act only addresses the economic functions they need to perform. This could be a predicament especially for DC and SEZ authority, involved in everyday functioning of SEZs.

⁵⁰ See, 'Chapter 7: Special Economic Zone Authority', *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/ Asadha 2, 1927 (saka), pp. 25-29.

Chart 2.2, Institutional Structure of the SEZs



Source: Mukherji, Rahul & Aparna Shivpuri Singh. 2006. "Investing in the Indian Special Economic Zones: A Background Paper" at the Institute of South Asian Studies, National University of Singapore, 30 May, Website: www.isas.nus.edu.org, date of access: 23/10/06.

It is pertinent to mention explicitly the political functions of the Development Commissioner and SEZ authority to facilitate smooth functioning of SEZs. Further, keeping in view the profit making nature of a trade zones, lack of social functions assigned to these authorities could also be a problematic area. However, more emphasis on political and social functions could discourage the investors. This issue is further discussed in chapter 4 and 5.

Procedure of establishing SEZs:

Studying the procedure of establishing an SEZ will bring into focus two aspects:

- The role played by the Centre and the State governments in establishing the SEZs. This will be useful in analyzing the Centre-state implications of SEZ policy in the fourth Chapter.
- By looking at the eligibility criteria and stages for setting up SEZs, the flexibility in the procedure is brought out. Such an exercise is extremely important especially when SEZs have the potential to alter significantly not only the economic but political and social fate of a large chunk of population.

Chapter two of the Special Economic Zones Act 2005⁵¹ and chapter two of 2006 Notification⁵² lay down the procedure for establishment of SEZs. Any person or company can make a proposal for setting up an SEZ. This proposal is made to the Development Commissioner. Depending on the nature of the proposal, the Development Commissioner forwards the proposal either to the Board of Approval or Approval Committee. Since there is a single window clearance system⁵³ the proposal has to go

⁵¹ See, 'Chapter 2: Establishment of Special Economic Zone', in *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/Asadha 2, 1927 (saka), p. 5.

⁵² See, 'Chapter 2: Procedure for Establishment of Special Economic Zone', in *Notification of Rules for SEZs, 2006*, Government of India, Ministry of Commerce and Industry (Department Of Commerce), Notification, New Delhi, 10th February, 2006, published in Part II, Section 3 Sub-Section (i) of The Gazette of India, Extraordinary, dated: 10th February, 2006, pp. 11-19.

⁵³ Single Window System is a trade facilitation idea. As such, the implementation of a single window system enables international (cross-border) traders to submit regulatory documents at a single location and/or single entity. Such documents are typically customs declarations, applications for import/export

through and gain approval only of the Board or committee. These authorities may approve, approve with suggestions or reject the proposal. Their decision, is then conveyed by the DC to the person making the proposal. Throughout this process of granting approval, Centre and State Government concerned, are consulted. The state government can also make similar proposal to the broad of approval. The Central government can, without referring to the Broad on its own, approve and notify SEZ in consultation with the State government. The criteria for granting approval has been mention in the Notification.⁵⁴ They relate only to National Foreign Exchange earning requirements and availability of space and supporting infrastructure. Enquiry of environmental issues and sector specific requirement is also made. However, exigent issues relating to wages, acquisition of land, compensation rates etc. are not taken consideration. If the concerned authority grants the approval, it is communicated to the Central government and the Development Commissioner issues a Letter of approval. If the land is in possession with the promoter of the SEZ then the proposal gains 'formal' approval, otherwise it retains 'in-principle' approval. The validity of this Letter is for a period of one year from the date of commencement of production or service activities. The last stage for setting up the SEZ is the notification of the area. The Developer after gaining the letter of approval will have to submit the specified information about the identified area to the Central Government. Once these requirements are fulfilled, the Government may then notify the specifically identified area in the state as a 'Special Economic Zone'.

This chapter addressed the question of 'What' are SEZs both in international and Indian context. The third chapter rises the 'Why' question relating to SEZs. It would seek to explore the rationale of adopting a policy like SEZ as a tonic for economic growth. It examines both the economic as well as political reasons of why Indian Government stressed on advantages and gains brought by SEZs among other alternatives available.

permits, and other supporting documents such as certificates of origin and trading invoices. The main value proposition for having a Single Window for a country or economy is to increase the efficiency through time and cost savings for traders in their dealings with various government authorities for obtaining the relevant clearance and permit(s) for moving cargoes across national or economic borders. Website: http://en.wikipedia.org/wiki/Single_Window_System, date of access: 21/01/08.

⁵⁴ See, 'Chapter 2: Procedure for Establishment of Special Economic Zone', in *Notification of Rules for SEZs, 2006*, Government of India, Ministry of Commerce and Industry (Department Of Commerce), Notification, New Delhi, 10th February, 2006, published in Part II, Section 3 Sub-Section (i) of The Gazette of India, Extraordinary, dated: 10th February, 2006, p. 12.

Chapter 3

The Formulation of Special Economic Zone Policy

Any policy that ensures both rapid and sustained improvement in quality of life of the people and faster economic growth is the best. For government of India, this also forms the basis on which any policy is adopted¹. The aim of the chapter is to look at this rationale for adopting the policy of Special Economic Zones. The chapter is divided into two parts. The first part tries to bring out the economic reasons for adopting the SEZ policy. It elucidates various objectives put forth by the act, which reflects the economic need for the policy. However, an economic need for a particular policy does not necessarily justify its adoption. For the same economic problem a number of remedies can exist. Hence, to understand comprehensively why the SEZ policy was adopted the second part of the chapter examines the political rationale of the SEZ policy. It is argued that the rationale for adopting the SEZ policy cannot be attributed to any one factor. A number of pressures acting on the State have engendered this action including the economic need, ideological inclination of the leadership and various other external and internal pressures of different groups.

Economic Rationale

The aims and objectives laid down by the government for adopting the policy of SEZs, brings out clearly the economic rationale for the same. The SEZ Act of 2005, that 'the Central Government, while notifying any area as a Special Economic Zone or an additional area to be included in the Special Economic Zone and discharging its functions under this Act, shall be guided by the following, namely²:-

- (a) Generation of additional economic activity
- (b) Promotion of exports of goods and services;

¹ Government of India. 1993. *Economic Reforms: Two Years After and the Task Ahead*, Department of Economic Affairs, Ministry of Finance, June.

² See, 'Chapter 2: Establishment of Special Economic Zone', in *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/Asadha 2, 1927 (saka), p. 8.

- (c) Promotion of investment from domestic and foreign sources;
- (d) Creation of employment opportunities;
- (e) Development of infrastructure facilities; and
- (f) Maintenance of sovereignty and integrity of India, the security of the State and friendly relations with foreign States.

These tell us why the need for SEZ policy arose. Therefore, each of these is discussed in detail below as a part of economic rationale. Most of the countries justify establishing Trade Zones³ for more or less similar reasons. Hence, a simultaneous discussion of the international experience of the trade zones would also be mentioned that inspired the government to adopt SEZs in India.

Promotion of Investment from Domestic and Foreign Sources:

Based on the colonial experience, private investment was always viewed with certain wariness. Foreign investments were seen as a source of threat because of its capacity to influence economic and political affairs and challenge sovereignty. At the same time, private domestic investment raised the concern of economic disparity, monopoly power and deprivation of social justice. Therefore, in most of the strategic sectors the central government fulfilled the need for investment and fuelled growth. This can be clearly seen in terms of the inducement given to power, defense, social infrastructure and basic and heavy industries. From the Third Plan to the Sixth, the ratio of planned investment between the public and private sectors has been 40:60.⁴ Private capital was countered by import-substitution policy, license Raj and a number of regulations like limitations on foreign equity, ownership, local content, local employment and minimum export requirements etc.⁵ However the paucity of funds to propel growth was felt as the economy could not generate enough resources for itself. This need was met through

³ Henceforth the word Trade Zones, EPZs, and SEZs would be used synonymously since the fundamental operating principle, as mentioned earlier, in each of them is similar and the difference between them is only of a degree and not of a kind.

⁴ Rudolph Lloyd and Susanne H. Rudolph. 1980. 'The Centrist Future of Indian Politics', *Asian Survey*, XX (6), (June), p. 578.

⁵ See, 'Foreign Direct Investment in Developing Asia', *Asian Development Outlook 2004*, World Bank, Website: http://www.adb.org/Documents/Books/ADO/2004/ADO2004_PART3.pdf, date of access: 5/03/08.

heavy borrowing from the International Financial Institutions and World Bank. By 1990-91, total external debt was 5,533 U.S. \$ million.⁶

Crisis of 1991, awakened to the fact that status quo could not be continued further. Three issues directed the need towards a change in investment policy. States did not have adequate funds to develop themselves because of insufficient transfers of funds from the Centre. Second, borrowing from International Agencies resulted in debt service and challenged independent policy making of the borrower. Therefore, an alternative to borrowing funds was sort. Third, international experience presented a different path of development. Within Asia there were seven economies – China, Singapore, South Korea, Taiwan, Vietnam, Malaysia and Thailand which had higher rate of GDP growth than India.⁷ Five out of these countries had adopted ‘Foreign Direct Investment (FDI) - Export led model of Growth’⁸. According to 2002 United Nations Conference on Trade and Development (UNCTAD) data, China with 32.5% had the highest share of FDI flowing in developing countries followed by Brazil with 10.2 %. India had a mere share of 2.1% because of the lack of attention paid to foreign investments. Table 3.1 on the next page shows the FDI inflow in the developing countries.

Another significant aspect of these economies was the presence of trade zones that contributed in hauling out large shares of foreign investment. A country like China, having socialist anchoring also established SEZs. Infact in 1982, foreign owned enterprises accounted for 66% of the total investment in the three SEZs (Kaohsiung,

⁶ Reserve Bank of India, Website: <http://indiabudget.nic.in>, date of access: 5/03/08.

⁷ Virmani, Arvind. 2004. *Foreign Direct Investment Reform*, Occasional Policy Paper, Indian Council for Research on International Economic Relations, April, Website: www.icrier.org, date of access: 06/03/08.

⁸ The hypothesis that foreign direct investment increases exports and thus leads to growth was put forth in the 4th Global Development Network conference in Cairo in January 2003. This idea has also been advocated by World Bank. According to the Bank, ‘Direct Investment is especially suited to contribute to the expansion of developing countries’ productive capabilities; and it should be available in spite of balance of payments problems as long as commercially viable investment opportunities exist. The current economic situation in developing countries calls therefore for a substantial expansion of foreign direct investment in developing financing.’ – as quoted in Paus, Eva. 1989. ‘Direct Foreign Investment and Economic Development in Latin America: Perspective for the Future’, *Journal of Latin American Studies*, Vol. 21, No.2 (May), p. 222.

Nantze and Taichung) in China.⁹ Other examples that have demonstrated a high degree of achievement in attracting foreign capital can be found in Republic of Korea (where 89% of total investment in Masan free export Zone is foreign) and Sri-Lanka (73% represented foreign capital in all the zones).¹⁰ It was believed that these economies succeeded in attracting FDI through SEZs and achieved higher degree of growth and prosperity.

Table 3.1, FDI Inflow into Developing Countries
(Share of developing Country total, %)

Host Region/ Economy	1989-94 (ann.avg)	1991-96 (ann.avg)	1995	1996	1997	1998	1999	2000	2001	2002
Developing Countries (in billion \$)	59.6	91.5	113.3	152.5	187.4	188.4	222	240.2	209.4	162.1
Argentina	4.5	4.7	4.9	4.5	4.9	3.9	10.9	4.7	1.5	0.6
Brazil	2.5	4.0	4.9	6.9	10	15.1	14.1	13.9	10.7	10.2
China	23.5	27.8	31.6	26.4	23.6	23.2	18.2	17.0	22.3	32.5
Indonesia	2.5	3.3	3.8	4.1	2.5	-0.2	-1.2	-1.9	-1.6	-0.9
India	0.7	6.6	1.9	1.7	1.9	1.4	1.0	1.0	1.6	2.1
Malaysia	6.2	5.9	5.1	4.8	3.5	1.4	1.6	2.3	0.3	2.0
South Korea	1.5	1.3	1.6	1.5	1.5	2.9	4.8	4.2	1.7	1.2
Singapore	8.1	7.5	7.8	6.8	6.9	3.3	3.2	2.7	5.2	4.7
Thailand	3.2	2.1	1.8	1.5	1.9	2.7	1.6	1.0	1.8	0.7
Taiwan	2.0	1.4	1.4	1.2	1.2	0.1	1.3	2.0	2.0	0.9
Vietnam	1.0	1.3	2.0	1.6	1.5	1.2	0.9	0.9	0.6	0.7

Sources: World Investment Reports, UNCTAD, various issues

This conclusion is based on the advantages that succeed these investments. That is to say, the benefit of investments and more specifically foreign investments are not limited to setting up manufacturing units and generating employment. There are number of other benefits, which accrue concurrently. Since FDI mostly flows from capital-intensive

⁹ Wong, Kwan- Yiu, and Chu, David K.Y. 1984. 'Export Processing Zones and Special Economic Zones as Generators of Economic Development: The Asian Experience', *Geografiska Annaler. Series B, Human Geography*, Vol. 66, No.1, p. 5.

¹⁰ Ibid.

countries (US and European nations etc), along with investments they transfer technical knowledge to the host countries by establishing units. This technology transfer is not limited to production processes for existing and new products but also organizational, managerial, marketing, distribution, procurement and logistics knowledge and systems.¹¹ Similarly, they impart skills to the local laborers. Second, since there is a shortage of funds available with host countries, FDI contributes in proper utilization of the local resources. Third, investments leading to establishing of units create backward and forward linkages with local industries thereby creating multiplier and spread effects in the local economies. Fourth, SEZs provides an opportunity to earn foreign exchange. During 1990's crisis India had just enough foreign exchange left to buy imports for 2 weeks.¹² Through the exports made by SEZs, the economy can ease the foreign exchange constraints and satiate the need for imports for the rest of the economy. Fifth, the returns on the private investments would depend on the performance of the project installed. For the smooth functioning and success of the project, special care would be given to the infrastructural facilities in and around the SEZ unit. Therefore, some part of the investment would also contribute in infrastructure building and thus economic upliftment of the region. In 2004, Prime Minister Manmohan Singh said that India requires nearly \$150 billion foreign investment to develop its infrastructure.¹³ Based on these gains, it is easy to understand the government's willingness to introduce the policy of SEZs and entice investments through concessions and incentives.

When EPZs were initially established in 1960s, the focus was only on domestic investments. India adopted a vigorous control of foreign investments resulting in limited flow of foreign funds. The SEZs established in 2005, though targeted both domestic and foreign investors but the focus has shifted to latter. The table 3.2 below shows the amount of total investment (domestic + foreign) made in SEZs. Investments play a very crucial role in augmenting growth. Needless to say that if the government is forgoing

¹¹ Virmani, Arvind. 2004. *Foreign Direct Investment Reform*, Occasional Policy Paper, Indian Council for Research on International Economic Relations, April, Website: www.icrier.org, date of access: 06/03/08.

¹² Corbridge, Stuart and John Harriss (eds.) .2000. 'Reinventing India: Liberalization, Hindu Nationalism and Popular Democracy', New Delhi: Oxford University Press, p. 151.

¹³ R. Krishnan .2004. 'National Carriers Need FDI Wings', *Business Line*, November.

approximately 1,00,000 crores which is a large sum of the total revenue to attract investments, importance of it cannot be undermined.¹⁴

Table 3.2, Private Investment (as on 31.12.07)

Investments:	Crores
In newly notified SEZs:	Over Rs. 67347 crore
In 12 St.Govt./pvt. sector SEZs prior to SEZ Act (Indore, Jaipur, Jodhpur, Moradabad, Surat, Nokia, Mahindra, Manikanchan, Salt Lake)	Rs. 2879 crore
Incremental Investment generated after February 2006	
i) Newly notified SEZs:	Rs. 67347 crore
ii) In 12 State Govt./Private SEZs	Rs. 1123 crore
iii) Government SEZs	Rs. 1946.26 crore
Total incremental investment	Rs. 70,416 crore
Expected investment in new generation Special Economic Zones:	
• By March, 2008:	Rs.1,00,000 crore including FDI of US \$ 5 – 6 billion.
• By December, 2009:	Rs. 2,85,279 crores

Source: <http://www.sezindia.nic.in/HTMLS/SEZs-VisibleGains.pdf> , date of access: 04/03/2008.

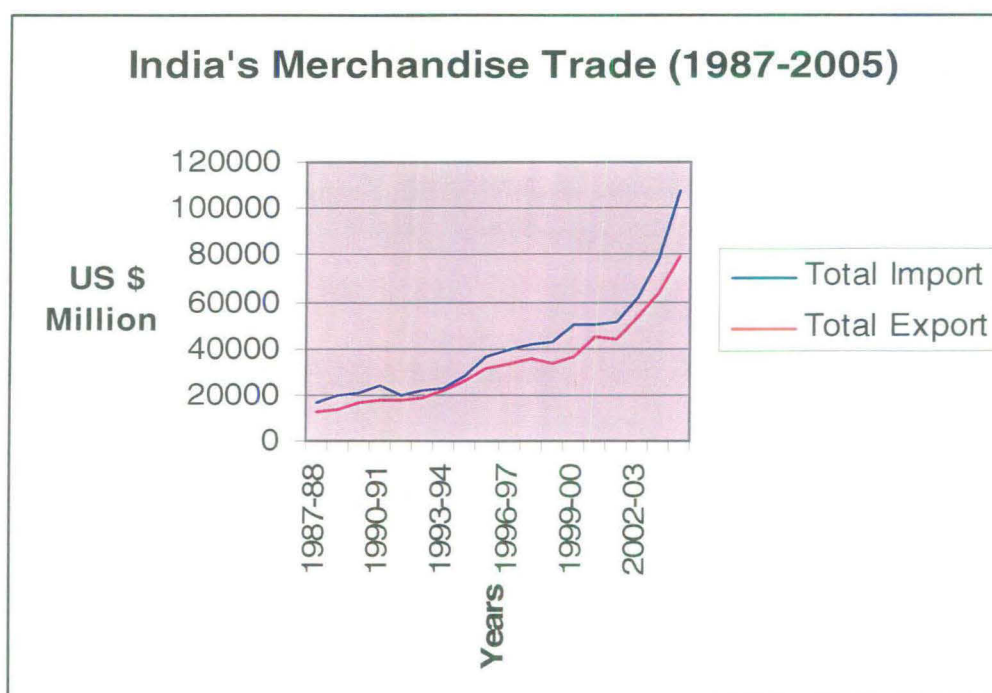
Promotion of Exports of Goods and Services:

SEZ as already mentioned is an export-oriented growth strategy to promote industrialization. The idea of an export led growth strategy is to achieve growth through exports in the foreign market. Further, it aims to reduce fiscal deficit created due to

¹⁴ Bidwai, Praful . 2006. 'The Great Land Grab', *Frontline*, Volume 23 - Issue 18, Sep. 09-22.

deficit in the trade account, which the earlier growth strategies failed to counter. Other alternatives close to EPZ or SEZ are import substitution policy¹⁵ and/ or the expansion of manufactured exports by local firms either independently or under arrangements, which are less dependent on multinational corporations and foreign capital.¹⁶ The experience of past years proved that import substitution policy was inefficient in achieving growth. The second alternative of exporting without external help, more challenging than the import substitution policy, did not work either. Infact, one of the main reasons during 1991 crisis was the trade deficit engendered by surplus of imports over exports. Graph 3.1 shows trade situation since 1987 and Graph 3.2 displays India's net exports vis-à-vis imports.

Graph 3.1, Trade Situation since 1987

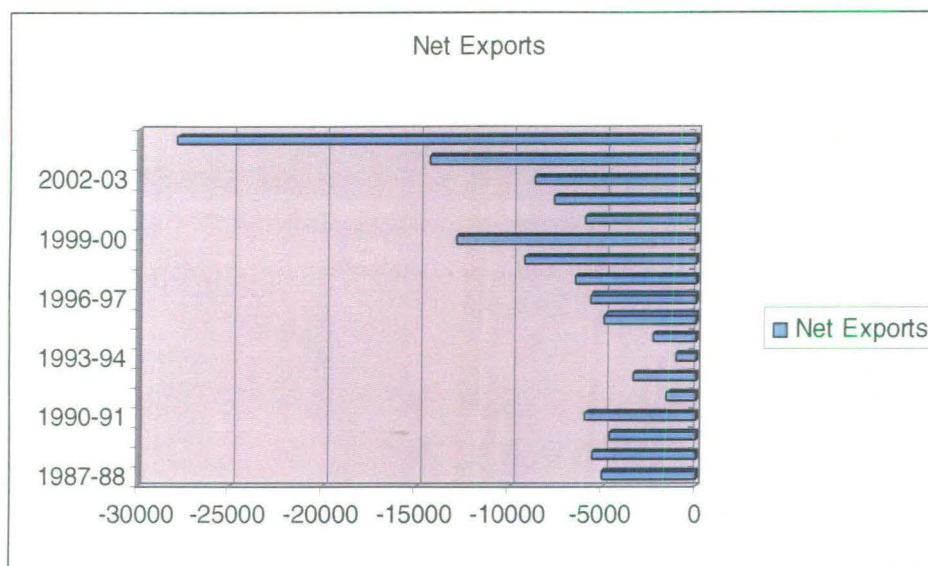


Source: Reserve Bank of India, Hand Book of Statistics on Indian Economy

¹⁵ 'Import- Substituting industrialization is based on the idea that domestic industrial diversification requires a degree of protection of the home market at least in the initial stages as well as the perception that foreign exchange resources are limited'. – Ghosh, Jayati. 1998. 'Liberalization Debates', in Terence J. Byres (ed.) *The Indian Economy: Major Debates Since Independence*, New Delhi: Oxford University Press, p.308.

¹⁶ Lee Eddy (ed). 1984. 'Introduction', *Export Processing Zones and Industrial Employment in Asia: Papers and Proceedings of a Technical Workshop*, Singapore: Koon Wah Printing Pte. Ltd, p. 19.

Graph 3.2, India's Net Exports vis-à-vis Imports



Source: Reserve Bank of India, Hand Book of Statistics on Indian Economy

Thus, growth through exports with the assistance of private and especially foreign capital was set as a target to strike a balance in a country that had followed import substitution policy for a very long period. To boost exports the policy of SEZ was introduced. At present, through SEZs the government has been able to export goods worth Rs. 22839.53 crores in 2005-06 and in 2006-07 Rs. 34,747.47 crores. The percentage increase between the two years has been 52.31%. The projection of exports for 2007-08 is Rs. 67299.62 crores (three times that of exports made in 2005-06).

Although the SEZ policy as an export strategy has several drawbacks, other alternatives were neither foolproof nor able to gain considerable success. Therefore, this policy seems more like an attempt to test an alternative growth strategy already introduced in several countries like Singapore and Taiwan, and concurrently also proposed by World Bank to several developing countries like Bangladesh and South Korea etc.

Creation of Employment Opportunities:

The logic of SEZs leading to employment is simple. Ample semi-skilled and non-skilled labor, ready to work at lower wage levels, with little governmental protection offered by flexible labor laws provide an opportune niche to foreign as well as domestic entrepreneurs to invest in production. This leads to employment generation. Further, the kind of industrial units established are usually labor-intensive and therefore able to produce even more employment. Eddy Lee says that trade zones have drawn considerable attention from the world community because of the strategic role it plays in the New International Division of Labor.¹⁷ This refers to relocating certain manufacturing industries to those countries where labor is abundantly available. Usually the transfer of employment is from Developed countries where labor is scarce and hence costly to Third World Countries where the labor, because of being abundant and usually unskilled is cheap. Foreign investment flows from MNCs, subcontracting production through setting up labor-intensive manufacturing units in Third World Countries. Hence, 'it has been observed that in the early stages of development of EPZs/SEZs in Asia, labor-intensive industries such as garment and electronics have been able to generate more employment than technology-intensive industries'.¹⁸ Several countries across the globe experimenting with EPZs/SEZs experienced tremendous success in attracting employment. For instance, Taiwan, planned employment for the three EPZs was 65,000 persons (EPZ administration, Taiwan 1981); but by end of 1979, the employment figures [had] reached a peak of over 80,000.¹⁹ Mexico was able to create one million jobs in 10 years in 'Maquiladoras'.²⁰ In Puerto Rico, employment grew by

¹⁷ See, Lee Eddy (ed). 1984. 'Introduction', *Export Processing Zones and Industrial Employment in Asia: Papers and Proceedings of a Technical Workshop*, Singapore: Koon Wah Printing Pte. Ltd.

¹⁸ Wong, Kwan- Yiu, and Chu, David K.Y. 1984. 'Export Processing Zones and Special Economic Zones as Generators of Economic Development: The Asian Experience', *Geografiska Annaler. Series B, Human Geography*, Vol. 66, No.1, p. 7.

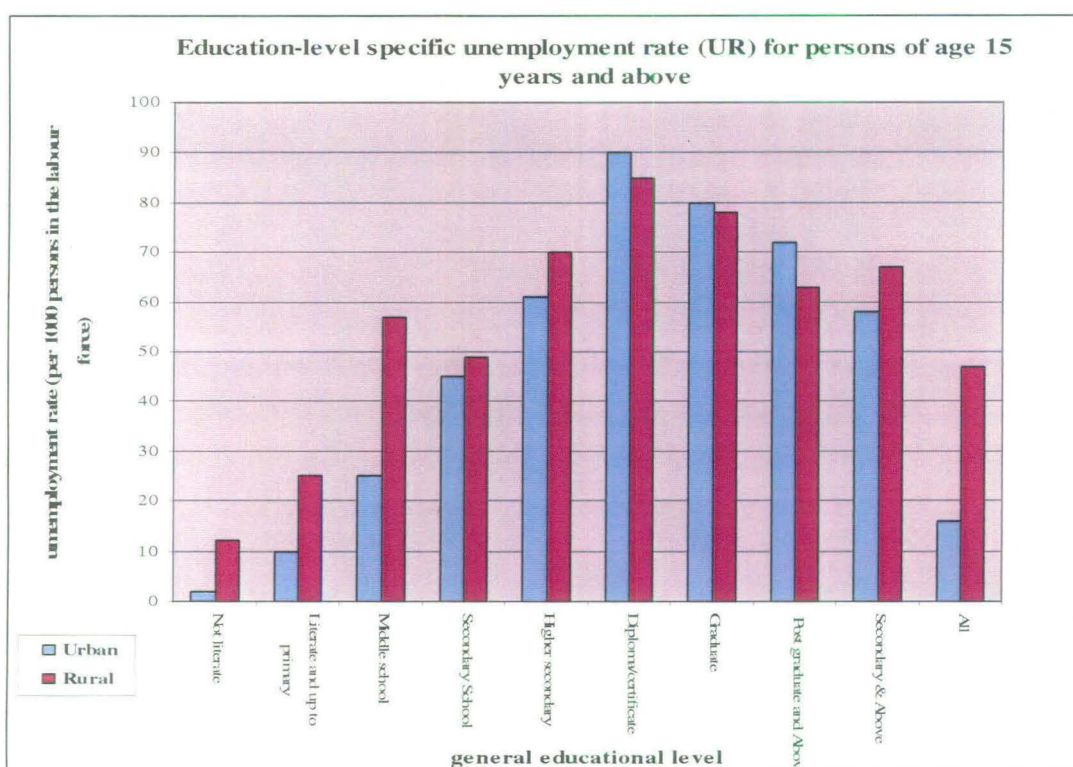
¹⁹ Ibid, pp.7. However, in many EPZs, the desired rate of employments predicted, has not been met. For example, the EPZ in Kandla, Gujarat produced only 1,400 employments and Bataan EPZ in Philippines generated only 25,000 as against 40,000 jobs predicted by the administration. When the predicted level of employment is not generated, it creates a problem because often this rate also covers for the jobs forgone for setting up SEZs.

²⁰ India SEZ Summit 2006: Driving Investments and Exports: Building Growth Centres', Confederation of Indian Industries, New Delhi, Website: http://cii.in/documents/WTO/SEZ_Background_Paper.pdf, date of access: 1/01/2008, p.10.

9% per annum for 40 years.²¹ Drawing from the international experience, setting up SEZs became a lucrative proposal.

India has a massive population of approximately 1.13 billion. Graph 3.3 shows the level of unemployment in the year 2006 per 1000 persons. On an all India basis, the level of unemployment rate among the educated persons was 6.7 per cent in rural areas and 7.4 per cent in urban areas.²²

Graph 3.3, Level of Unemployment in the Year 2006 Per 1000 Persons in India



Source: NSS Report No. 522: Employment and Unemployment Situation in India: July, 2005-June, 2006

Employment generation has been a key issue since time immemorial as through it poverty can be targeted. It leads to building up of a safety net for the poor and in general increases demand for consumption and attracts investment for further development. Various policies to resolve the problem of unemployment directly or indirectly have been

²¹ Ibid.

²² 'Unemployment Rate among Educated Youth', May 17, 2006, Website: http://pib.nic.in/release/rel_print_page1.asp?relid=17746 date of access: 3/03/2008.

launched since post-independence. For the UPA government, employment generation was a bigger concern. Prof. Hasan argues that Congress was able to form a government at the centre in 2004 because of the support it received from underprivileged, poor and marginalized citizens who were disgruntled with BJP and its policy bias towards more affluent sections of the society.²³ Consequently, the National Common Minimum Programme emphasizes on employment and National Rural Employment Guarantee Program.²⁴ The rationale for SEZs has to be gauged in this context. SEZ policy aims to provide employment to rural youth in labor-intensive industries like Textiles & Apparels, Leather Footwear, Automobile components, Engineering etc. The table 3.4 shows the employment generated by SEZs. The government was able to achieve a greater level of direct employment than what it expected to create by December 2007 (ie 1,00,000 jobs).²⁵ Whether the government would be able to sustain this employment rate would become evident only in future.

Table 3.4, Employment in Special Economic Zones (as on 31.12.2007)

Current Direct Employment in the SEZs:	Jobs
i) In the 7 Central Government SEZs	1.83 lakhs
ii) SEZs notified under the SEZ Act 2005	61,015
iii) 12 private/State Government new generation SEZs set up/notified prior to SEZ Act 2005	36,463
Total (I + ii + iii)	2,80,478
Expected Employment by December 2009	17,43,530 additional jobs

Source: <http://www.sezindia.nic.in/HTMLS/SEZs-VisibleGains.pdf> date of access: 04/03/2008.

²³ See, Hasan, Zoya. 2006. 'Bridging a Growing Divide? The Indian National Congress and Indian Democracy', *Contemporary South Asia*, Vol. 15(4), December, pp. 473-488.

²⁴ 'National Common Minimum Programme of the Government of India', May 2004, Website: <http://nac.nic.in/ncmp.htm>, date of access: 28.01.2008.

²⁵ 'SEZs', Website: <http://india.gov.in/sectors/commerce/sezs.php> date of access: 04.03.2008.

However, the generation of employment is not adequate, the character and quality of jobs offered are equally important. Several concerns, again based on international experience, figure in pertinently in the case of employment generation. It is often argued that the industries target particularly the venerable segment of the labor force in the host countries, which is mostly of young girls. They are often paid lower wages too.²⁶ For instance 80% of female labor is employed in Taiwan's Bataan EPZ. In Hyderabad Gems SEZ for Jewellery manufacturing in Hyderabad has employed 2000 persons, out of which 1200 are women in 2007.²⁷ Second, the employment generation is often unstable because SEZs are first in line to face the brunt of the volatile and changing nature of the local and global economy. It becomes particularly bad when there are no rules relating to entry and exit from SEZs. Third, 'another characteristic of these jobs is high intensity of work-long hours per day, shift work at unsocial hours and a very high number of working days per year; all at an unrelenting pace and under demanding productivity norms'.²⁸ Fourth, these jobs have very low skill content and training is given for a very short duration. Hence, these jobs do not exactly impart skilled to the labor force. Lastly, in the longer run, when development takes place in the SEZs, either the investors move to new areas, because of rise in wage demand or they adopt more sophisticated technology and thus cut down on the labor employed. The above-mentioned issues often contest the approach and rationale of SEZs leading to employment generation. A detailed study of the employment and labor question is done in chapter 5.

Development of infrastructure facilities:

The concept of SEZ is often considered an improvement over EPZs, because of its capacity to contribute in the overall development of the region. This is not only because the SEZs, through exports can engender higher economic returns, but also because they

²⁶ Lee Eddy (ed). 1984. 'Introduction', *Export Processing Zones and Industrial Employment in Asia: Papers and Proceedings of a Technical Workshop*, Singapore: Koon Wah Printing Pte. Ltd, pp.1 – 26 and also Ghosh, Jayati. 2002. 'Globalization, Export- Oriented Employment for Women and Social Policy: A Case study of India', *Social Scientist*, Vol. 30, Nos. 11-12, Nov- Dec, pp. 17-60.

²⁷ 'Background note on Special Economic Zones in India', Website: <http://www.sezindia.nic.in/>, date of access: 04/03/2008

²⁸ Lee Eddy (ed). 1984. 'Introduction', *Export Processing Zones and Industrial Employment in Asia: Papers and Proceedings of a Technical Workshop*, Singapore: Koon Wah Printing Pte. Ltd, p. 14.

can contribute in the overall development of the infrastructure. The term 'infrastructure' includes:²⁹

- Physical infrastructure within the zones: includes water, electricity, warehousing, transport, telecommunication, police station, fire station and banks
- Physical infrastructure external to the zone: includes transport facilities for the zones, roads leading to the zones and port facilities.
- Social infrastructure within the zone: comprises of residential complexes, schools, hospitals and recreation facilities.

The Developer of the SEZ will have to invest in the infrastructure in and around the zones for regularized, good quality and cheap production, maintaining a fit labor force and generating higher growth rate. Incentives given by the government is in a way giving concession to the investors who undertakes risk of developing the infrastructure, which has a long gestation period.³⁰ A FICCI- World Bank research paper states that 'India will require an investment of USD 70 billion per annum for the next five years in infrastructure to complement its high level of GDP growth'.³¹ Out of this, the government desires that at least 30% should come from the private investment.³² Hence, the SEZs come across as a viable alternative.

However, this presumption that SEZ can create better infrastructural facilities is often treated as a 'chicken and egg' problem.³³ According to the SEZ Act of 2005, among others, one reason for establishing SEZs is to augment the infrastructure within the regions. This, they believe would take place when the investment will be made in the region by the SEZ developers. Hence, the government has made the infrastructural

²⁹ 'Special Economic Zones – Engines for growth', CII, May 2006, Website: www.ciionline.org, date of access: 11/10/2006.

³⁰ 'Interview with Mr. R Seshasayee, President, CII', 26 September, 2006, Website: www.ciionline.org, date of access: 11/10/2006.

³¹ 'India needs \$70 b yearly infrastructure investment', *The Political and Business Daily*, February 17, 2007, Website: http://www.ficci.com/news/viewnews1.asp?news_id=941, date of access: 20/02/2007.

³² Subramaniam, Kandula . 2007. 'Montek: can't compare with China on infrastructure investment', *Indian Express*, 5th December.

³³ See, Mattew, Vinod .2005. 'Infrastructure or SEZ investment', *Business Line*, March 31. Also see, Patnaik, Prabhat. 2005. 'The UPA Regime and Economic Policy', Website: http://www.macrosan.org/cur/mar05/cur310305UPA_Regime_1.htm , date of access: 10/03/2008.

outlay mandatory for the developers. Contrary to this, many argue that SEZs are able to attract investments only when proper infrastructural facilities are available. For instance, heavy foreign inflow of funds have taken place in China (where infrastructure-user investment ratio of 1:40 by SEZ user unit as compared to India, which is 1:5)³⁴, Singapore and South Korea because they had strong infrastructural facilities to offer. Second, only a miniscule proportion of the total investment flows for infrastructural development. At present only Rs. 23,300 crores out of Rs. 67,347 crores of private investments has gone into infrastructure building.³⁵ In most of the countries, therefore domestic governments make these investments. Further, Aradhna Aggarwal in her study on export processing zones argue that though the infrastructure within EPZs are generally superior to that available in the wider economy, but they are neither satisfactory nor are able match world class standard.³⁶ Table 3.5 on the next page shows her finding about the inadequate infrastructural provisions present in the zones in 2004.

Therefore, there is a need to monitor the infrastructural development within the SEZ units. Another concern relating to infrastructure is that of real estate building. There has been a growing concern that because of the number of incentives given by the government, SEZs can lead to more real estate building than goods manufacturing. The government has allowed up to 75% of the area within SEZs to be used for non-export purposes such as housing, schools, entertainment, and banks. This can defeat the purpose of SEZ, which aims not only to bring investments, but most importantly, to use these for manufacturing exports. Investment in non-export purposes though, might lead to building of social infrastructure, but would not aid the productive capacity of the nation. Further, profit-earning being the main motive, the social infrastructure would cater more to the needs of economically well-off.

³⁴ Ibid.

³⁵ <http://www.sezindia.nic.in/HTMLS/SEZs-VisibleGains.pdf> , date of access: 04/03/2008.

³⁶ Aggarwal, Aradhna. 2004. 'Export Processing Zones in India: An analysis of the Export Performance', Working paper no. 148, Indian Council for Research on International Economic Relations, website: www.icrier.org , date of access: 15/12/2007.

Table 3.5, Infrastructural Provisions Present in the Zones in 2004

	Falga	Cochin	Chennai	Noida	Vizag	Kandla	Surat
Water: Exclusive arrangement	Yes	Yes		2 Tubewell, 4 underwater reservoir	4 borewell	Central Storage facility	Bore well
Water purifier	No	Yes	Yes	No	No	No	Under construction
Effluent Treatment	No	Yes	Yes	No	No	No	Not required
Electricity: Exclusive arrangement	No	Yes	No	No	No	No	No exclusive arrangement
Captive power plant scheme Storage	Yes	No	No	No	Yes	-	Not operational
ICD	No (under process)	Yes	Yes	Same as above	No	Yes (in 2003)	Yes
Telecommunication	Yes	Yes	Yes	BSNL	Stpi. Bsnl	BSNL	BSNL
Financial Infrastructure							
Banks	1	2	2	4	2	4	None
OBU	No	Yes (2004)	No	2 (not operational)	No	None	Not operational
ATM	None	2	2	1	1	None	None
Post office	No	1	1	1	1	1	None
Social utilities							
School	No	No	No	No	No	No	Yes
Hospital	No	Yes	No	No	No	No	Yes
Fire	Yes	No	No	No	No	Yes	No
Hotel	Guest house	No	Guest house	No	Guest house	Guest house	Guest house
Recreation	Yes	No	Yes	No	Yes	Yes	No
Shopping Complex	No	No	No	No	Yes	Yes	Yes
Area dedicated to social utilizes and residential	1.05%	> 0.5	Nil	Nil	8.2	7.0%	6%

Source: Aggarwal, Aradhna. 2004. 'Export Processing Zones in India: An analysis of the Export Performance', Working paper no. 148, Indian Council for Research on International Economic Relations, website: www.icrier.org, date of access: 15/12/2007.

Generation of Additional Economic Activity:

Creation of SEZs has a spillover effect also. They lead to generation of economic activities not only within the zone, but also through backward and forward linkages, in the areas surrounding the main land. These linkages have a predominate role in the industrial growth. Backward linkages are established for sourcing raw materials and sub-contracting a part of manufacturing operations, while sales in the domestic market

represents forward linkages.³⁷ Creation of these backward linkages mainly depends on the type of the industrial unit established within the zone. For the products such as garments, textiles and leather linkages can be forged easily; this might not be the case for electronic items. Creation of backward linkages depends on the policies of the government. For instance, in China, a 'policy of uniting with the interior', is vigorously followed.³⁸ Other example is that of Masan and Iri zones in South Korea where the proportion of domestic supplies of raw material surged to one-quarter in a short period of four years.³⁹ However, most of the SEZs in Asia have generated very limited effect on domestic economies as the units have high import content owing to tax relaxations. Backward linkages in the form of subcontracting are also very limited. In addition, forward linkages with domestic markets are basically precluded by the dependence of the Zones on export markets and the very limited access to domestic markets allowed by host government.⁴⁰ The same holds true in the Indian case. The Government fears that the SEZ developers might enjoy all the concessions and put the products made in SEZs in the domestic market. This would not contribute in earning foreign exchange. Therefore, only three percent of the total production in SEZs, can be sold in the domestic market.⁴¹

Financial Constraints of the States:

According to Rudolphs, there has been a 'marked decline in public investment and, as a consequence, of the Centre's financial leverage. Capital expenditure of both the centre and states as a ratio of total government expenditure [has] declined from 31.2 per cent in 1980-81 to 14.62 per cent in 1995-96'⁴². Based on this they conclude that the central government does not have the funds to invest for the various needs of the society on its own. Further, borrowing is not a viable alternative because of the already existing *huge deficits* and high, as well as, rising rates of interest. In 1998-99, the interest payments as

³⁷ See, Kundra, Ashok .2000. *The Performance of India's Export Zones: A Comparison with the Chinese Approach*, New Delhi: Sage Publications, p. 30.

³⁸ Ibid

³⁹ 'Export Processing Zones: The Case of the Republic of Korea', UNIDO, 1995, Vienna, pp. 30.

⁴⁰ Wu, Weiping and Hooshang Amirahmadi. 1995. 'Export Processing Zones in Asia', *Asian Survey*, Vol. 35, No.9. (September), p. 842.

⁴¹ See, 'Parliamentary Debates on SEZs'; May 9th and 10th, www.loksabha.nic.in , date of access: 10/03/2008.

⁴² Rudolph, Lloyd and Susanne Hoerber Rudolph. 2001. 'Iconisation of Chandrababu: Sharing Sovereignty in India's Federal Market Economy', *Economic and Political Weekly*, May 5, p. 1543.

a ratio of the centre's revenue receipts were 52 per cent. Both these factors- interest payment and deficit has according to Rudolphs, reduced its capacity to help the states with investment funds. The centre's *gross assistance to states' capital formation* declined from 27 percent of the centre's revenue expenditure in 1990-91 to 12 per cent in 1998-99 to 6.1 per cent in 2005-06.⁴³

In another study, C.P. Chandrasekhar and Jayati Ghosh argues that the role of the Centre as the *creditor* to the states has already declined quite sharply over the past five years, and the value of the central loans outstanding has fallen both in nominal value terms and as a share of the total outstanding debt of the States.⁴⁴ Further, the debt situation of each state was quite acute. In some states, the debt-GSDP ratios of more than 40 per cent and interest payments amounting to more than 28 per cent of revenue receipts was present in the year 2002-03. Table 3.6, on the next page provides this information⁴⁵.

The 12th Finance Commission, in its report brings out the two-fold problem related to transfer of funds. The need for funds required by states is growing and as the same time the transfers made from the Centre are not adequate⁴⁶. A case study of West Bengal will further elucidate the problem. While explaining the West Bengal government's approach to industrialization and SEZ, the CPI(M), points out the financial constraints faced by the state government⁴⁷. It is clearly suggested that West Bengal can no longer continue to rely on agriculture where land is being fragmented because of inheritance, price of primary inputs going up and remunerative prices to farmers is low and fluctuating. Hence, there is need to focus on industrial sector.

⁴³ Latest figures calculated on the basis of the Tables on 'Gross Capital Formation from Budgetary Resources of the Central Government', and 'Major Heads of Expenditure of the Central Government', Website: <http://www.rbi.org>, date of access: 16/03/2008

⁴⁴ Chandrasekhar, C. P. and Jayati Ghosh. 2005. 'Death of Fiscal Federalism', *Businessline*, June, 07.

⁴⁵ Ibid.

⁴⁶ See, 'Twelfth Finance Commission', Website: www.fincomindia.nic.in, date of access: 07/03/2008.

⁴⁷ 2007. "*West-Bengal Government's Industrial Policy: Fact and Fiction*", Published by P.M.S. Grewal on behalf of the CPI(M) Delhi State Committee, and Printed at Progressive Printers, New Delhi, March. Also see 2005. "*A Left Stand on Policy Issues*", A CPI(M) Publication, Published by Hari Singh Kang on behalf of the CPI(M) Delhi State Committee, and Printed at Progressive Printers, Delhi, April and '*We are Committed to Making Industrial Progress*', speech delivered by the West Bengal Chief Minister, Comrade Buddhadeb Bhattacharya on 3rd January, 2007 at Kolkata on the occasion of Ganashakti's 41st Foundation day.

Table 3.6, Debt Profile of the States in 2002-03

States	Debt to GSDP ration (per cent)	Share in Total debt of States (per cent)
A.P.	28.95	7.5
Bihar	55.33	4.79
Chhattigarh	25.46	1.2
Goa	28.15	0.45
Gujarat	33.93	6.61
Haryana	27.95	2.7
Jharkhand	24.28	1.29
Karnataka	25.12	4.72
Kerala	36.34	4.65
M.P.	32.28	4.07
Maharashtra	21.56	9.51
Orissa	62.93	4.23
Punjab	48.51	5.52
Rajasthan	45.38	6.31
T.N.	26.8	6.02
U.P.	39.08	11.9
West Bengal	41.15	10.46
Arunachal Pradesh	55.45	0.18
Assam	33.91	1.94
H.P.	63.25	1.71
J & K	53.8	1.65
Manipur	43.08	0.31
Meghalaya	32.17	0.22
Mizoram	81.56	0.27
Nagaland	52.1	0.38
Sikkim	60.27	0.13
Tripura	37.78	0.46
Uttaranchal	32.37	0.8

Source: Chandrasekhar, C. P. and Jayati Ghosh. 2005. 'Death of Fiscal Federalism', *Businessline*, June, 07.

Complaining that the Centre-States financial relationship is skewed in favor of Centre, the West Bengal government points out how crucial transfer of resources from Centre then becomes in the industrial and other developmental activities. It gives a list of

financial constraints faced by the West Bengal state government that shows how the gap between the funds from the Centre and the states requirement has not been met⁴⁸:

- The per- capita national average of Central grants to states during the 2002-05 was Rs. 1630 wherein the per capita grant to West Bengal was only Rs. 830. This show there was a decline of per capita transfer to West Bengal, which was almost half of the national average.
- The per-capital financial assistance disbursed by financial institutions to West Bengal was Rs. 2780 upto 2001, which was less than the national per capita assistance amounting to Rs. 4828. Similarly, loans from NABARD to West Bengal were Rs. 21 per capita as compared to the national per capita average for loans that was Rs. 120.
- The study shows that the interest rates on the loans by - both the markets and the Central government are high. As a result, the West Bengal has fallen into the debt trap, so much so that the interest rate exceeds the Gross State Domestic Product (GSDP) rate as mentioned in the report on State finances, 2006-07. This has led to high debt- GSDP ratio as in many other states. Based on the recommendations of the 12th finance commission the Central government can allow the states to pay these loans at a soft interest rate of 7.5 % only if it accepts fiscal responsibility legislation Act, which inevitably means reduction of the development expenditure.
- Lastly, according to the West Bengal government, when the Central government is gradually retreating from spending in development projects, pursuing the task of people's development has become a Herculean task.

Therefore, the 'need' for a policy that seeks solution in terms of large-scale employment, earning foreign exchange and developing infrastructure definitely exists. However, can the economic rationale of a policy along justify its adoption? Further, was the SEZ policy the only alternative? To understand this, we need to look at the political

⁴⁸ 2007. "*West-Bengal Government's Industrial Policy: Fact and Fiction*", Published by P.M.S. Grewal on behalf of the CPI(M) Delhi State Committee, and Printed at Progressive Printers, New Delhi, March.

justifications and rationale for adopting the policy of SEZ, which the next section attempts to do.

Political Justifications:

The 'State' is a key element for introducing and implementing any policy. To explain why the State adopts a policy in any obvious terms, however is difficult. Consider this; any economic problem, which emerges is objective in nature. It is accepted that a problem exists and a suitable policy for dealing with such a problem needs to be devised. However, the solution to such a problem tends to be subjective because it involves making a political decision of selecting a particular economic solution among the others⁴⁹. Hence, an economic cause alone does not lead to adoption of a policy. The presence of political forces in determining a decision cannot be overlooked. Similarly, ideological as well as social forces can also exist. The point is that no one reason can govern the being of a policy. The State is at any given time is acted upon a multitude of factors. That is, a number of pulls and pressures are exercised on the State by various elements of the society that could range from domestic social groups to economic classes to state leadership and to external actors and structures.⁵⁰ This brings us to the issue of State autonomous.

A number of scholars have argued that the state is constrained and therefore not completely autonomous. Scholars like Lloyd and Susanne Hoebner Rudolph, say that state in India has come to occupy a dominant position in the society. Its dominance is because of its overwhelming control of investment and employment in the organized sector, and

⁴⁹ Atul Kohli describes the existence of a similar situation during the 1991 crisis. He demonstrates how economic liberalization was also a political decision rather than being a purely economic solution. According to him, when the crisis occurred, scholars and economist agreed that the hurdle to accelerated development of economy was, 'an industrial sector which could perform better'. This was an objective problem. However, 'the economist who studied the "objective economic situation", simply [were] not in agreement that there is one best way to solve the problem'. In such a situation if a particular set of response is adopted, it is a political decision depending on the forces acting on the Indian state. – Kohli, Atul. 1990. *Democracy and Discontent: India's Growing Crisis of Governability*, Cambridge: Cambridge University Press, pp 308-309.

⁵⁰ See, Pedersen, Jorgen Dige.2000. 'Explaining Economic Liberalization in India: State and Society Perspectives', *World Development*, Vol.28, No.2, pp. 265-282.

to its ideological advantage, as presumed defender of the collective interest and socialist purposes and as the enemy of private and partial gains⁵¹. Consequently, the state has brought into existence a class, which increasingly serves itself rather than achieving any commonly held goals of the society. However, this class is not insulated from the society. Often various 'demand groups' put pressure on the state to achieve their goals. These groups are adhoc and come from unorganized section. Therefore, autonomy of the state, based on interaction with the society, according to Rudolphs, has to be 'located on a continuum ranging from complete state domination of society to complete societal domination of the state'⁵². They give four potential positions of the state:

- a) Totalitarian (when the state completely dominates the society),
- b) Autonomous (the state is mainly self determining but for maintaining legitimacy and consent in the society get constrained),
- c) Constrained (freedom is limited both for maintaining legitimacy and consent and by representation of organized social forces) and
- d) Reflexive (where in, state is completely subsumed by organized interests or class).

The state's location on the continuum will depend on the ideology, leadership, conjunctural effects and balance of public and private power. This means that the degree of autonomy enjoyed by the State is not permanent and is continuously changing. Therefore, post liberalization, it is important to look into these factors to understand the dynamics of policy-making.

Similarly, Pranab Bardhan argues, that Indian State is autonomous in terms of regulating rather than playing any developmental role. At the time of independence, the leaders because of their active participation in freedom movement came to enjoy a great degree of legitimacy within the society. Further, the leadership which Bardhan calls as 'state elites', had a common ideological purpose i.e. promoting national economic development through the State. Consequently, they succeeded in reorganizing and developing the economy on their own terms with considerable autonomy, amidst class constraints exercised by dominant economic class. However, 'as the aura of special legitimacy of

⁵¹ Rudolph, Lloyd and Susanne Hoebler Rudolph. 1987. *In Pursuit of Lakshmi: The Political Economy of the Indian State*, New Delhi: Orient Longman Limited, p. 13.

⁵² Ibid, p. 61

leaders derived from their participation in the freedom movement and serving in British prisons waned in the wheeling- dealing of day to day post independence politics (and as some of the widely respected figures of that generation passed away), they could get away with fewer and fewer of the autonomous policy directives and the constraints becoming binding'.⁵³ These constraints came from three dominant propriety classes - industrial bourgeoisie, agrarian bourgeoisie or rich farmer class and professionals or public bureaucracy. In the recent years, the arrival of burgeoning middle class is also according to Bardhan a part of the dominant classes. However, the State exercises relative autonomy because these groups are heterogeneous and highly divided giving leverage to the policy makers to manoeuvre.⁵⁴ They are not made on the behalf of any specific socio-economic group, but the presence of several constraints on the basic conception, as well as, its implementation is noticeable.⁵⁵ In this sense the function of the state has become more regulatory and patronage dispensing rather than developmental.

According to J. D. Pedersen, several factors since 1991 have constrained the autonomy of the State. With the decline in the number and growth of governmental companies there has been a simultaneous increase in private business in India. This, he terms as 'quiet revolution'. There has been 'a gradual emergence of a technologically more advanced segment among industrial companies, small – medium and large scale', and 'these industries have begun to contribute more to the output and export than previously'⁵⁶. What is more important is that these companies have started to show professional mannerism, rather than being 'traditional family based system'. Consequently, a change in political organization of these private industries has also occurred. This can be seen in the case of Confederation of Indian Industries (CII), which has gained a lot of prominence in last few years. They claim to develop 'proactive' 'partnership approach'

⁵³ Bardhan, Pranab. 1984. *The Political Economy of Development in India*, New Delhi: Oxford university press, p 39.

⁵⁴ Time and again such policies are made which are not in favor of the bourgeoisie. For instance, the recent loan waiver of the farmers' by the government of India in the budget 2008-09.

⁵⁵ See, Bardhan, Pranab. 1993. 'A Political –Economy Perspective on Development', in Bimal Jalan (ed.), *The Indian Economy: Problems and Prospects*, New Delhi: Penguin Books, pp. 321-337.

⁵⁶ Pedersen, Jorgen Dige. 2000. 'Explaining Economic Liberalization in India: State and Society Perspectives', *World Development*, Vol.28, No.2, p. 268.

to its working with Indian government.⁵⁷ A change has also occurred in the convictions and interests of private industries in terms of favoring 'deregulation, de-control and de-licensing' in all areas and actively endorsing globalization.⁵⁸ The general point is that the landscape of Indian industry has undergone a major change from the mid-1980s onward, a change that resulted in the strengthening of a new set of interests and a new pattern of representation giving Indian industrialists a broader menu of options while seeking to influence public policy-making⁵⁹.

Similarly, according to Pedersen, three external factors have come to affect the autonomy of the state especially since 1991⁶⁰:

a) The operations and impact of international markets in goods and finance: For Patnaik, International Finance Capital has influenced the autonomy of the Indian state. This finance capital is a huge bloc of finance, which is highly mobile, having extensive global reach, is not rooted in any particular industry or sector, mainly owned by metropolis though does not represent any specific national character and moves around the global in quest of opportunities for quick profit.⁶¹ The Bretton Woods institution emphasizes on removal of all restrictions on capital flow reflecting the interest of international finance capital to access the Third World economies. It entered into the Indian scenario mainly after the 1991 crisis, which led to the introduction of 'liberalization-cum-structural adjustment' package. The introduction of this package brought change in the role of State. It retreated as a producer and investor, but came to support the presence of large capital (FDI and FII). It sorts to bring foreign private investment in a big way.

b) Ideological 'linkage' mechanism: This refers to the external impact on ideas and interests of important domestic actors especially state leadership emanating from their exposure to the outside world.

⁵⁷ See, Kochanek, S. A. 1996. 'Liberalization and Business Lobbying in India', *Journal of Commonwealth and Comparative Politics*, 34(3), pp. 155-173.

⁵⁸ See, *ibid*, pp. 270.

⁵⁹ *Op. cit.*, S. A. Kochanek, 1996, p. 240.

⁶⁰ See Pedersen, Jorgen Dige. 2000. 'Explaining Economic Liberalization in India: State and Society Perspectives', *World Development*, Vol.28, No.2, pp. 265-282.

⁶¹ Patnaik, Prabhat . 2000. 'The State in India's Economic Development', in Zoya Hasan (ed.) *Politics and the State in India*, New Delhi: Sage Publications, pp. 142-157.

c) The third mechanism is direct exercise of power or leverage in negotiating between foreign actors (IMF and the World Bank among others) and the Indian government. This was during 1991 economic crisis when the government of India had to accept structural adjustment policies and introduce fiscal disciplinary measures in return of the loan given by IMF). However 'the government's present commitment to continue the reform policy in a situation of booming foreign reserves is somewhat difficult to attribute to market-transmitted external compulsions'.⁶²

Based on the above it can be argued that the State at any point in time is constrained by a conjuncture of both internal and external factors. These factors exert pressure on the state and determine its actions. To say therefore, that the State is completely autonomous in making any policy decision might not be accurate. Similarly, to say that the state is governed only by economic rationale of a policy or its consequence benefits to only a particular section of the society would be faulty. An over-determined reality exists, where a multiple factors in conjuncture engender a certain action of the State. The same holds true in the case of SEZs. The nature of the policy is such that it cocoons the capitalist to attract investment and achieve export led growth. In this sense, the policy favors the capitalist class. However, this is not the only reason.

The need for the SEZ policy is evident to bolster the growth of the country. China, a socialistic country has adopted a capitalist policy like SEZ. This is despite the fact that free trade zones have flexible labor laws, liberalized terms of trade and privilege foreign investors whose main purpose is to earn profit. This means that there is some merit in the policy and that it is not just adopted for the benefit of the capitalists. As already mentioned, the policy is a very powerful idea, which even though cocoons the investors, aims to bring foreign exchange, provide employment, build infrastructure, bring advanced technology and forge backward and forward linkages in the economy. This is not to suggest that all benefits accrue in all the economies with maximum capacity or that it is the best solution for achieving growth. However, a country which needs to boost its economic growth, provide employment to its world's second largest population and build

⁶² Ibid, p. 271.

infrastructure would show its preference for a policy of SEZ. A comparison of Natural Rural Employment Guarantee program launched in 18 districts of Madhya Pradesh with SEZ in Indore shows that former is able to generate 18,04,953 jobs for an expenditure of Rs. 40380.9 Lakhs in 2006-07.⁶³ Whereas a single SEZ in Madhya Pradesh has been able to generate 10,67,626 jobs besides boosting exports and contributing in the overall regional development.⁶⁴

Similarly, on the domestic front, both West Bengal and Kerala ruled by the communist parties have adopted the policy of SEZ. West Bengal is an exception because it was successfully able to implement land reforms. Further, Atul Kohli has empirically proved how West Bengal under the CPI (M) has been reasonably successful in not only formulating and implementing more pro-poor policies (land reforms, programmes aimed at small farmers and wage employment schemes for landless laborers) but also has been able to resist the infiltration of vested interest at the local level.⁶⁵ Concurrently Goa has been able to demand scrapping of SEZs because it the SEZs can potentially hurt the existing economy of Goa. However, this was also possible because Goa has a comparatively well developed economy that is able to draw huge foreign earning through tourism. Hence, to assume that the policy is made in favor of capitalist is to overlook the need, which exists for such a policy because the states do not have sufficient funds to develop itself as explained earlier.

Further, a greater constraint exists. The SEZ policy might not be the best strategy for ensuring inclusive growth but it is definitely one of the most potent tactics for attracting foreign investment. With the number of tax concessions and incentives given, flexible labor laws operating and privileges offered to the developer, the investments are bound to flow in the region where SEZs operate as compared to any other region where they do not exist. Therefore, even if adopting a policy of SEZ is against the ideological inclination of

⁶³ 'Performance of States in NREG implementation', Ministry of Rural development, Krishi Bhawan, New Delhi, Website: <http://darpg.nic.in/arpd-website/conference/chiefssecyconf/nreg.ppt#256,1,Performance of States in NREG Implementation>, Date of access: 16/03/2008.

⁶⁴ 'Industrial Scene: M.P.', Website: <http://www.sezindore.com/industry.htm>, date of access: 16/03/2008. However, for a proper analysis the jobs forgone and revenue also needs to be considered.

⁶⁵ See Kohli, Atul. 1987. *The State and Poverty in India: The Politics of Reform*, Bombay: Orient Longman.

the party they are invariably compelled to adopt it in need of funds. Various other reasons for adopting the policy SEZ are a variety of political advantages including a compromise between liberal and protective regime, a gateway to international community and smaller political cost.⁶⁶ With the decline in power of former Soviet Russia, a New World Order has been established. In this 'new order', North has come to play a very important role in world politics. FDI flowing from north into the SEZs can facilitate relations with the West and help avail aid and consensual support in strategic issues. For instance the 'Persian war increased developed countries' fears of possible intervention by North through force' and thus 'these countries seek to minimize risk by trying to unify with the developed world through hosting FDI from the North'⁶⁷. SEZ is less of a political risk because it is better than opening up the entire country to foreign and private participation. Establishing SEZ has already created a lot of upheaval. If the ultimate aim is to liberalize the entire economy, SEZ can both be a less risk to experiment with the idea and become as a transient stage before the final step.

An examining of the ruling party, Congress, that introduced the policy also enumerates the reasons why SEZ policy was adopted. The need to abide by the National Common Minimum Programme as well the support of the leadership towards pro-globalization policy is the two most important factors that led to adoption of SEZs policy. However, these have created a predicament for the Congress. A study of this will throw light on the multiplicity of factors responsible for adopting SEZ policy. According to Prof. Hasan, 14th general elections was significant because it brought into focus the context of the country's growing economic divide and unequal distribution of opportunities and wealth⁶⁸. Congress was successfully able to win the elections because it was able to accentuate this key issue through its *aam admi* agenda amidst 'India shinning' campaign. Consequently, 'ever since the INC-led government began implementing social and economic policies designed to pursue the liberalizing agenda of economic reforms, the INC has struggled to reconcile the contradiction between economic reforms that benefit

⁶⁶ See Amirahmadi, Hooshang and Weiping Wu .1995. 'Export Processing Zones in Asia', *Asian Survey*, Vol. 35, No.9. (Sep.), pp. 828-849.

⁶⁷ Ibid, p. 833

⁶⁸ Hasan, Zoya. 2006. Bridging a growing divide? The Indian National Congress and Indian Democracy', *Contemporary South Asia*, 15(4), December, pp 473-488.

the elite and upper middle classes and its mass support base among the poor who have been the losers in this process'⁶⁹. Four components- programmes as embodied in policies, leadership, organization and social base of congress can help delineate the interplay of factors which contributed to the adoption of the SEZ policy. As mentioned in the first chapter, Congress after independence came to represent 'a catch all' 'umbrella party'. It was able to draw support across castes, classes, regions and communities. After 1984, the support base of congress declined. From 1996-1999, there was a sharp erosion as well as a change in the support for congress of a peculiar kind. This erosion of votes came from shift in the support of upper and middle classes and /or the upper class from Congress to BJP⁷⁰. While the support of the poor, slum dwellers, the unemployed, marginalized and unemployed continued to stay with the party. Concomitantly, with the introduction of economic reforms by the P.V. Narasimha Rao a two-way shift occurred – towards markets internally and towards United States externally. This brought a change in the approach of various political parties. They involved a shift from a multi-class state committed to pro-poor measures to a narrow conception of the state more closely aligned with business, capital and middle class avowedly supportive of capitalist development⁷¹. Hence, according to Prof. Hasan Congress is caught between a tug of war. On one hand it is trying to woo middle class and maintain its social base by a policy making tilt in favor of the corporate sector and economic interests. On the other hand, it has to make such policies that benefit the poor and ensure equitable distribution. At present, since Congress party's support is unevenly distributed its policies are also less centrist than it used to be.

Leadership and organizational strategy also reflect the same predicament. Since Indira Gandhi, there has been centralization of the party and the rein of the Congress decision-making has been in the hands of the top-notch government leaders. At present, this leadership is reflecting ambiguous approach. On one hand Dr. Manmohan Singh, Kamal Nath the Minister for Commerce and Industry, Montek Singh, member of planning

⁶⁹ Ibid.

⁷⁰ Yadav, Yogendra, Sanjay Kumar and Oliver Heath. 1999. 'The BJP's New Social Bloc', *Frontline*, 19th November, pp. 32-33.

⁷¹ Kohli, Atul .2006. "Politics of Economic Growth in India, 1980-2005; Part-2: The 1990s and Beyond", *Economic and Political Weekly*, 8th April, pp. 1361-1370.

commission are clearly in favor of open liberalized economy. Whereas the President of Congress Party Sonia Gandhi is widely perceived to be pro-poor and committed to social development as reflected in her insistence on increasing social sector allocation in developmental policies⁷². Therefore, 'the party embraces neither the genuine politics of the poor nor can it afford to be openly elitist' and 'seeks to address the needs and aspirations of both the sector'⁷³. Further, not only does the party have a lack of leadership but it also secludes those who try to bring links a between politics and policy as it might upset the centralized power structure. Related to it is the relatively poor organizational strategy to bring different economic and political programmes under one central plan of action. The effect of it is also seen which often the party is unable to harmonize with the various regional and states based parties with whom a coalition is entered. The party has to therefore, face the pressure from these regional parties often driven by regional elites⁷⁴ to formulate such policies that are a compromise.

This tussle is also evident in the programmes embodied in policies made by the government including SEZs. The 11th five-year plan, the National Common Minimum Program, various speeches delivered by President, Prime Minister, Members of National Advisory Council, Rehabilitation Policy etc all resonant the same issue⁷⁵. For instance the Prime Minister, Dr. Singh while taking over his post mentioned that 'the government would have to focus on the poor, the rural, the agricultural sector. We have to provide water, schools, health facilities, jobs for the youth and a favorable environment for

⁷² Hasan, Zoya. 2006. Bridging a growing divide? The Indian National Congress and Indian Democracy', *Contemporary South Asia*, 15(4), December, pp. 481-482.

⁷³ Ibid.

⁷⁴ See, Baru, Sanjay. 2000. 'Economic Policy and Capitalism in India', in Francine R. Frankel, Zoya Hasan, Rajeev Bhargava and Balveer Arora (ed.). *Transforming India: Social and Political Dynamics of Democracy*, New Delhi: Oxford University Press.

⁷⁵ See, "Towards a faster and More Inclusive Growth, An Approach to the 11th Five Year Plan", Government of India, Commission Yojna Bhavan, New Delhi, 9th December 2006, Website: www.planningcommission.gov.in, date of access: 06/08/07, 'National Common Minimum Programme of the Government of India', May 2004, Website: <http://nac.nic.in/ncmp.htm>, date of access: 28/01/2008, Government of India. 1993. *Economic Reforms: Two Years After and the Task Ahead*, Department of Economic Affairs, Ministry of Finance, June, 'Surging Economy Must Reach the Last Person in Social Strata: Pratibha Patil', *Financial Express*, 25th January, 2008, 'Comparative Statement of National Policy for Resettlement and Rehabilitation of Project Affected Families (NPRR-2003) and National Rehabilitation Policy (NRP-2006)', published by: Government of India, Ministry of Rural Development, Department of Land Resources, Website: www.dolr.nic.in/NRP2006-draft.pdf, date of access: 06/08/07, Rangajaran, C. 2006. "Employment and Growth", 20th July www.eac.gov.in, date of access: 06/08/07.

business and industry to flourish'⁷⁶. In this context, the main issue that the government is trying to address through its various policies is the trade off between two contradictory but equally desirable virtues – growth and equity. The tussle between the two virtues has existed since independence days. Nevertheless, what is being emphasized is that one is not a substitute for other. Social justice in the absence of economic growth or vice versa will yield the same repercussions in the society and undermine democracy. These two virtues are complimentary to each other and a balance has to be achieved. The mistake lies in trying to make one virtue dominate the other in an abstract search for perfect society. The idea is let one adapt to another in a cooperative manner over time. Hence, the policy of SEZ might not be the best possible solution to the economic problems witnessed however, since the 'need' for such a policy exists it cannot be ignored. Similarly, this policy cannot undermine the need to maintain equity and social justice. Therefore, what is more important is search for a balance between the two and see how SEZs can become a tool of 'inclusive growth'.

The next chapter examines the implications of SEZ policy from a centre-state perspective. In the context of interaction between federalism and liberalization, what is attempted is to see whether liberalization actually leads to decentralization of the political structure.

⁷⁶ 'We will Focus on the Poor': Manmohan Promises Secular, Stable government', *The Hindu*, 21 May 2004.

Chapter 4

Centre-State Relations and Special Economic Zones

“Let me make it very clear that it is not humanly possible to set up a SEZ without State government’s active support or participation”¹

-Kamal Nath

Union Ministry of Commerce and Industry

This statement is an indicator of what is going to be examined in this chapter. The aim is to see how ‘centralization’ in a federal polity is affected by the adoption of a New Economic Policy like Special Economic Zone. This chapter is divided into two main parts. The first section looks at political process of federalization of political parties and economic reforms. These processes form the background of decentralization within the Indian polity. It is argued that the conjunction of both economic reforms and federalization of political parties have fundamentally altered the balance of power between the centre and the state governments. The next section, specifically, delineates this transformation through the study of SEZ policy. The policy is scrutinized from three perspectives: legislative authority, executive process and functioning. It concludes, by arguing, that the autonomy experienced by the state in comparison to 1960-80s has enhanced. Post 1990s, participation of states in decision-making as well as independence in determining fiscal issues has increased. However, the cooperation between centre and the states as well as liberty for the states to govern several administrative issues is lacking. Further, a tendency of the giving responsibilities more than powers to the state governments by the Centre is noticed.

Post 1980s, two most important processes changed the nature of Indian federalism. Different political parties from below and the compulsion to liberalize from the

¹ ‘Discussion on the Special Economic Zone Bill, 2005’, Lok Sabha Debates, May 10th, 2005, Website: www.loksabha.nic.in , date of access: 21/02/2008.

international organizations contributed to the decentralization of the structure. Therefore, it is pertinent to study both the changes and their impact on Indian federation.

Political Processes:

After independence, despite one-party dominance the centre-state relations were quiet amiable. Congress was successfully able to incorporate different interest and ideologies within its ambit. However, with Indira Gandhi coming to power the situation began to change. There was decay of institutions and by 1975 centre-state relations reached its lowest ever. However, the culmination of emergency led to a counter response. It intensified the demand for increased recognition and autonomy of the states at national level. According to Prof. Balveer Arora, these demands for reform in the federal polity were mainly centered on two broad themes²:

- More participation of the states in national policy-making. This demand for more space and voice also sought greater influence, and eventually empowerment, in matters concerning vital interests of the states³.
- The states demanded more autonomy in governing themselves. This included both administrative as well as financial spheres⁴.

The response to these demands was met naturally through two most important political processes that has shaped Indian polity and revitalized Indian federation. These processes are federalization of political parties and economic reform.

Federalization of Political Parties and its impact on Centre-state Relations

Chapter one attempted to explain the shift in Indian polity from centralization to decentralization due several factors by tracing 50 years of Indian federation. The most important change that contributed towards this shift was the transformation in the party system. It was argued that due to the factors mentioned below a shift in the status and power exercised by state based and regional parties was witnessed:

a) Decline of Congress due to shrinking of parties support base,

² See, Arora, Balveer. 2001. 'Coalitions, Reforms and the New Federal Polity', *Social Action*, Vol. 51, July- September, pp. 283-302.

³ Ibid, p. 284.

⁴ The scope of this study is limited. Therefore, a broader analysis of decentralization from the issues of – President's rule, civil services, Inter state council etc. are omitted.

- b) Over-centralization brought by Indira Gandhi,
- c) Democratic upsurge,
- d) Rise of regional parties partly encompassing the aspirations of regional elite and partly endorsing regional and vernacular discourses
- e) Nature of Indian constitution

Different scholars typified this shift differently. For some it denoted ‘rise of new power centres’, ‘fragmentation of party system’, for some it was a move from ‘dominance to competitive multi-party system’, and yet for others it was ‘federalization of party system’. The central theme in each was the eminent position the ‘states’ have come to acquire with the aid of state based and regional parties in the India polity. What is attempted in this section is therefore to examine the new role of the states in terms of the political advantage they have come to enjoy post 1980s.

There is a need to analyze how far states have been able to determine broader parameters of political policy decisions. This can help bring out the actual sovereignty exercised by the state governments. It is true that the importance of states has increased at national level. According to Prof. Zoya Hasan, this can be measured with their growing ability to make or mar the government at the Union level⁵. Unlike past, when the state parties were mere addendum to the Central government, they have now come to redefine the rules of making the government at the centre. With the changes in Indian polity, there has been a rise of regional parties and a shrinking of the support base of national party who have failed to secure absolute majority at the centre. The table 4.1 below shows the rise in the percentage of the seats occupied by the regional parties in the Lok Sabha elections.

Table: 4.1, Percentage of Lok Sabha seats occupied by regional parties (1952-98)

	1952	1957	1962	1971	1977	1980	1984	1989	1991	1996	1998
Seat	3.2%	1.6%	2.8%	5.1%	6.9%	3.8%	4.1%	10%	4.6%	9.4%	9.7%

Source: Saez, Lawrence. 2002. *Federalism Without a Centre: the Impact of Political and Economic Reform on India's Federal System*, New Delhi: Sage Publications, pp. 61

⁵ See, Hasan, Zoya. 2004. ‘The New Power Centres’, *Frontline*, April 23, pp.4-7.

In 1996, since the seats occupied by regional parties was 9.4%, for the first time a non-Hindi speaking, regional party leader H. D. Deva Gowda became the Prime Minister of the country. Further, since 1996 it has become clear that no national party like BJP or Congress can form a government without the support of the regional parties. The best example of this has been the support given to BJP by Telegu Desam Party in 1998 elections when BJP fell short of 22 seats needed to form the government at the centre and also later to maintain the coalition. Thus, regional parties have been catapulted to a position where they can contest the national parties in terms of power. However, this is not to suggest that state parties can replace the national ones. Both national and regional parties need each other to form coalitions as the latter does not have national reach and that the former is unable to secure absolute majority. What is being suggested is that a space for the regional parties has been carved out. Through participation at the national level, the state based parties are able to bring changes according to its policy beliefs and needs.

Subsequently, the bargaining capacity of the states has increased. The state level parties often are able to manipulate the Centre to obtain certain favors or policy changes. For example, in the coalition government formed by BJP in 1998, Jayalalitha of AIADMK, persistently 'used her magnified leverage within the BJP government to make demands to stall a series of corruption investigations against her', and demanded 'a reshuffling of the cabinet to increase the share of cabinet positions for her party'⁶. Of late, the UPA government has not be able to sign the Indo-US nuclear deal because CPI (M) is refusing to cooperate with the government on this front. This shows that states are now able to exercise influence even in those spheres that are reserved for the national government⁷. This capacity to negotiate with the Centre is beneficial for the state governments. Often they have been able to win favors for there respective state and increase their developmental opportunities.

⁶ Saez, Lawrence. 2002. *Federalism Without a Centre: the Impact of Political and Economic Reform on India's Federal System*, New Delhi: Sage Publications, p. 64.

⁷ See, Arora, Balveer. 2006. 'From Reluctant to Robust Federalism', in Mary E. John, Praveen Kumar Jha and Surinder S. Jodhka (eds.), *Contested Transformations: Changing Economies and Identities in Contemporary India*, New Delhi: Tulika Books, p. 25.

Therefore, for many the shift in the party system has contributed fundamentally to strengthening and rejuvenating Indian federalism. This is mainly because unlike earlier times, the role of states in national decision-making has increased significantly. However, anomalies to this also exist. For example, the central government made an agreement on agriculture with WTO, without consulting the state governments despite the fact the agriculture is a 'state subject'⁸. Such overriding powers negate states sovereignty. It shows that the administrative autonomy given to states is limited. States are more likely to get various benefits from the central government because of coalition. Their capacity to determine broader policy decisions seems limited. In the case of SEZ, the central government formulated the main policy framework but the state governments were left independent to work out details and specificities. However, the problem emerged when the Goa government decided to scrap all the SEZs established within the state. The Central government, however, denied that the state governments have authority to denotify the SEZ. The Commerce Secretary, Mr. Pillai, said that 'States have no power to de-notify SEZs. They have no locus standi to withdraw the notifications to the SEZs'⁹. This is because SEZ have gained approval from Central Board of Approval. The SEZ Act is also silent on the same. If SEZs can only operate with the assistance of state governments, as will be seen later, then can such a strong central stand be acceptable?

Economic reforms

India adopted a centralized planned economy model. States had limited fiscal autonomy in terms of both collection and allocation of resources. The Central government collected the lion's share of taxes, a portion of which was transferred to the states under the formula established by the Central government Finance Commission¹⁰. The power to allocate these, along with loan and grants also given by the Central government was placed in the hands of Planning Commission and central government ministers. It was believed, that through such a system the regional disparity would be reduced and that

⁸ Chatterjee, Bipul .2001. 'WTO and Centre-State relations -- Proactive stand could make a difference', *Businessline*, February 21.

⁹ 'Goa can't scrap notified SEZ, says Centre', *Financial Express*, 2008, January 02.

¹⁰ Vyasula, Vinod. 1996. 'Finance Commission in a Federal Set-up', *Economic and Political Weekly*, 5th October, pp. 2719-21.

developmental priorities for the states could be established. The state governments had little power to influence these transfers or investment decisions besides lobbying for it in the parliament. The states would often complain that the transfers made by the centre were discriminatory in nature. There was a kind of helplessness among the states, which had to adhere to the conditionality put forth by the centre to obtain loans and grants. For example, 'in early 1990s, Kerala's government complained of having to spend precious resources on non-priority areas like –irrigation, but said they had to do so in order to obtain central funding'¹¹. At the same time, since the states kept demanding larger share of revenue, grants and loan forgiveness there was a growth of state's fiscal deficit. The situation at the Central level also worsened. This resulted in the crisis of 1991 and as a remedy, the Centre adopted structural adjustment reforms.

This economic reform package had three major thrust areas: fiscal discipline, administrative deregulation and privatization of economic activities hitherto in the public domain through disinvestment¹². All these factors influenced the states' dependence on centrally transferred funds and its role in economic decision-making. Fiscal discipline meant that the centre would have to transfer fewer amounts of fund to the states to control its expenditure and reduce deficit. Consequently, other avenues where states could fend for themselves needed to be opened. Thus, we see the adoption of NEP (new economy policy) where the states will have to compete in the open market for private investments. Further, since the centre is increasingly allocating inadequate funds, both the developmental priorities and implementation of the policies, would be placed in the hands of the state. Administrative deregulation meant rolling back of the centre and with it centralized planning structure. This meant the Centre could no longer intervene with its permits and licenses. Lastly, with disinvestment, the state governments now will have to take initiative to build upon its own infrastructural facilities and take care of its own social service expenditure. This clearly indicates that the balance of power between the

¹¹ Kennedy, Loraine.2004. 'The Political Determinants of Reform Packaging: Contrasting Responses to Economic Liberalization in Andhra Pradesh and Tamil Nadu', in Rob Jenkins (ed.), *Regional Reflections: Comparing Politics Across Indian States*, New Delhi: Oxford University Press, p. 32.

¹² See, Arora, Balveer. 2006. 'From Reluctant to Robust Federalism', in Mary E. John, Praveen Kumar Jha and Surinder S. Jodhka (eds.), *Contested Transformations: Changing Economies and Identities in Contemporary India*, New Delhi: Tulika Books, p. 23.

centre and the states has altered. Further, a fundamental change in terms of how the states related to the central government and more broadly to the global as well as local economy has taken place. The states have become far more autonomous in their sphere of working especially in terms formulation and implementation of their economic policies. Due to decentralization, there has been a decline in the central regulations and states have the liberty to borrow funds from international market. This might have a pernicious consequence. The states might indulge in populist policies like providing subsidies on power, irrigation to increase their vote bank. This can lead to an increase in their fiscal deficit¹³. Hence, there is a need for the central government to monitor.

Both the rise of state based and regional parties and economic reforms, in there own way were responsible for altering the exiting situation. Conjunction of both these processes put a lot of pressure on the centre to decentralize. This resulted in the rise of states as agents of development and autonomous units. The SEZ policy will help in bringing out the same as well as point out certain areas where the centre needs to decentralize further.

The Special Economic Zone as a Growth Strategy

For many, the policy of SEZ was a path-breaking legislation¹⁴. This was because, the policy could ensure economic prosperity and more importantly it gave the responsibility to the states, to take India on the path of development. Keeping in mind, that the policy is at an experimental stage, its implication for centre-state relations and Indian federal policy is analyzed at large. This is done by looking at three specific issues:

Legislative authority

This section examines the legislative authority, the SEZ Act holds. Further, it also looks at the distribution of powers and responsibilities between the centre and the states:

¹³ See, Weiner, Myron. 1999. 'The Regionalization of Indian Politics and its Implication for Economic Reform', in Jeffrey D. Sachs, Ashutosh Varshney and Nirupam Bajpai (eds.), *India in the Era of Economic Reforms*, New Delhi: Oxford University Press, pp. 261-295.

¹⁴ See, 'Discussion on the Special Economic Zone Bill, 2005', Lok Sabha Debates, May 10th, 2005, Website: www.loksabha.nic.in, date of access: 21/02/2008.

a) Problems within the law: The SEZ Act is a watershed legislation in giving the objective of economic growth top priority. It is also novel in the sense of placing tremendous responsibilities in the hands of the state government. However, an analysis of the act brings out certain loopholes, which can prove to be adverse to the federal structure. The basic problem is that on one hand, there is need to ensure equity and harmony of interest and on the other it is equally pertinent to make the law of SEZ attractive so that investor finds it appealing enough to come and invest. Failing on latter could be detrimental to the growth of the country. Efforts to reconcile both the issues have made the law very fuzzy, incomprehensive and inadequate. According to V. Ventakesan there were three clauses in the law that met a lot of opposition in the parliament¹⁵. These sections though later rectified, brings out areas of conflict within a federal polity.

The first relates to the power enjoyed by the SEZ authority. Section 49 (1) (a) states '*The Central Government may, by notification, direct that any of the provisions of this Act (...) or any other Central Act or any rules or regulations made there under or any notification or order issued or direction given there under (...) shall not apply to a Special Economic Zone or a class of Special Economic Zones or all Special Economic Zones*'¹⁶. This Act therefore has the capacity to take precedence over any provisions of the constitution. Even if this is the case theoretically, it is problematic because Constitution is like a bible, which has contributed centrally to India's survival as a nation as well as has reinforced democracy. To give precedence over constitution, therefore is to undermine this fact and essentially move towards uncharted zones. Giving such overriding power to the Act may create a situation of administrative chaos in the areas of SEZ.

Section 3(4) states, "*in case a state government intends to set up a SEZ, it may, after identifying the area, forward the proposal directly to the board for the purpose of setting up the SEZ. Provided that the central government may, after identifying the area, suo*

¹⁵ Venkatesan, V. 2006. "Left Impact", *Frontline*, 20 October

¹⁶ See, 'Chapter VIII: Miscellaneous', in *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/ Asadha 2, 1927 (saka), pp. 33.

*motu, set up and notify a SEZ without referring the proposal to the state government concerned or the board*¹⁷. This section not only undermines the authority of state governments but also brings out the discriminatory nature. Objections regarding the Central government's authority to establish SEZ without prior consultation with the state government were raised¹⁸. This was unacceptable especially when land, water and other facilities would be provided by the concerned state. To ignore the consent of state government could dysfunction the SEZ. This clause also goes against the spirit of federal structure, which lies at the centre of the entire legislation. Consequently, amendment was made in the original bill, according to which central government could set up and notify SEZ only after consulting the state government.

Section 50 said: *"the State government may for the purposes of giving effect to the provisions of this Act, notify policies for developer and units and take suitable steps for enactment of any law granting exemption from the state taxes, levies and duties to the developer or the entrepreneur"*. It further said: *"Directing that any of the provisions of any state act relating to trade unions, industrial and labor disputes, welfare of labor including conditions of work invalidity, old-age pensions, and maternity benefits or any other activity relating to the SEZ shall not apply"*¹⁹. This section implies that states have to forgo collection of taxes from SEZs as well as have flexible labor laws. The majority in the parliament and especially the left parties were not in favor of such a position. Consequently, the government deleted the clause exempting application of any State Act relating to trade unions, industrial and labor disputes, welfare of labor etc., while drafting Section 50 of the Act²⁰. In addition, it also deleted the clause denying old-age pension, maternity benefit etc.

Besides having problems with these particular sections within the SEZ act, various Public Interest Litigations (PIL) have been filed in the High Courts and Supreme Court against

¹⁷ Ibid.

¹⁸ See, 'Discussion on the Special Economic Zone Bill, 2005', Lok Sabha Debates, May 10th, 2005, Website: www.loksabha.nic.in, date of access: 21/02/2008.

¹⁹ See, *The Special Economic Zones Act 2005*, Section 49 (b) Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/ Asadha 2, 1927 (saka), p. 33.

²⁰ Venkatesan, V. 2006. "Left Impact", *Frontline*, 20 October.

the authority given by the legislature to the executive through SEZ Act. Various PIL challenge legislature's decision on the grounds that it violates the Articles 14 (right to equality and equal protection before law), 19 (protects various rights to freedom), 21 (guarantees protection of life and liberty) and 301 (guarantees freedom of trade and commerce throughout India)²¹.

b) Distribution of Powers and Responsibilities: One of the most important ways in which the balance of power tilts towards the centre is the ultimate constitutional paramountcy given to the Centre. However, two factors have contributed to a shift in the balance of power between the Centre and the states. First, the impact of policy processes, which the constitution fails to depict. Second, the nature of constitution. A reading beyond article 356 (President's rule), all India Services, single judiciary etc. will delineate the fact that the constitution has given quiet a number of powers and responsibilities in the hands of the states. The table 4.2 on the next page shows this distribution.

Since 1991, the focus has shifted from the centre to the states' capacity to develop themselves. This has highlighted the powers and responsibilities of the states as well. For instance, authority concerning implementation and smooth functioning of the SEZ, lies within the states' jurisdiction. The SEZ have been established in the states and have affected various domains within the state subjects- land, power, electricity, municipality, panchayats, sales tax, octroi and trade etc. Infact, the Union Minister of Industry and Commerce, Mr. Kamat Nath, in context of SEZ said, 'Today, I think the largest players, the largest responsibility, the largest involvement will be that of the state governments'²². Hence, it is evident that the central government has to some extent actually given both fiscal and administrative autonomy to the states. However, two areas of concern have emerged. First, 'new areas of tension are emerging, arising from rethinking the role of Union government in the economic sphere and the opposition of states to policies that they perceive as imposing additional burden on them. While they welcome the transfer

²¹ Jishnu, Latha and Feroz Ahmed. 2006. 'Sovereign States?', *Businessworld*, 13th November, p. 46

²² 'Discussion on the Special Economic Zone Bill, 2005', Lok Sabha Debates, May 10th, 2005, Website: www.loksabha.nic.in, date of access: 21/02/2008.

of powers and resources, they resist the transfer of responsibilities that the centre is seeking to shed²³.

Table 4.2, Constitutional Distribution of Legislative Powers and Executive Responsibilities between the Union Parliament and the State Assemblies in Key Developmental Areas

Developmental Area	Union List	State List	Concurrent List
Land		Land rights, tenures, Rents, transfer improvement (18), water supplies, storage, power, irrigation and canals (17)	Forest (17A)
Water	Inter-water rivers and river valleys notified by law in public interest (56)	Water supplies, storage, power, irrigation and canals (17)	
Electricity, Power and Energy	Atomic energy (6)	Gas and Waters (25)	Electricity (38)
Agriculture and Fisheries Industry	Fishing/Fisheries beyond territorial waters (57), Industries notified by law for national defense (7), or to be in public interest (52)	Agriculture (14), livestock (15), Other fisheries (21), Other industries (24)	Factories (36)
Oil, Mines, Minerals	Mineral oil/ petroleum (53), mines and minerals notified by law to be in public interest (54)	Other mines and minerals (23)	
Trade and Commerce	Foreign trade and commerce, import/export, customs frontiers (41), inter state trade and commerce (42)	Trade and Commerce within the state (26), production, supply and distribution of goods (27), Market and fairs (28)	Trade and Commerce, production, supply and distribution of foodstuff, edible oils, raw cotton jute (33)
Transport and Communication	Railways (22), national highways (23), national waterways (24), maritime shipping (25), major ports (27), airways (29), rail/sea/ air carriage of passengers and goods (30)	Other roads and means of communication (13)	Other ports (31), shipping and navigation on inland waterways (32)
Education	Universities and Institutions of national importance for scientific/ technical education and research (63-66), national survey (68)		Education, including technical and medical, university, vocational, technical training (25)
Information and Broadcasting	Posts/ telegraph/ wireless/broadcasting and communication		
Public Health	Port Quarantine (28)	Public Health and sanitation/ hospitals and dispensaries (6)	Infectious/contagious disease (29)
Social Welfare and Security		Relief of disabled/ unemployable (29)	Economic and social planning (20), Population control (20A), social security/ insurance/ employment/ unemployment (23), labor Welfare (24)
Local government and co-operatives		Municipal corporations and local self-government bodies (5), Public Works (35), Cooperative societies (32)	

Source: See, Arora, Balveer. 2006. 'From Reluctant to Robust Federalism', in Mary E. John, Praveen Kumar Jha and Surinder S. Jodhka (eds.), *Contested Transformations: Changing Economies and Identities in Contemporary India*, New Delhi: Tulika Books, pp. 20.

²³ See, Arora, Balveer. 2006. 'From Reluctant to Robust Federalism', in Mary E. John, Praveen Kumar Jha and Surinder S. Jodhka (eds.), *Contested Transformations: Changing Economies and Identities in Contemporary India*, New Delhi: Tulika Books, p. 29.

This issue will be examined again under the executive process. Second, even though there has been a decline of the interventionist role of the Centre, it has emerged as a regulator. It will try to reduce fiscal deficits by imposing and monitoring hard budget restraints. In addition, the states will also have to deal with market forces, which will constantly evaluate its success and rank it. According to Rudolphs, 'the states have found that the price of freedom is more responsibility for growth and fiscal discipline'²⁴. This in a sense is good because the states' performance can be supervised and to some extent defaults can be rectified. However, for states which falter it might led to Centre's intervention.

Executive Process

Providing legislative authority by the means of an Act does not in itself assure the smooth functioning of an act. Certain problems arise when the act is implemented and so several issues are involved in the case of SEZs as elaborated below:

a) Unequal distribution of authority between the centre and the state: An examination of the institutional framework of SEZ brings out that the power is tilted in favor of the central government. The board of approval (BoA) immediately after the Union MOCI, has only one representative from the states. However, once BoA approves the proposal it is then send to respective state governments for approval. It is only at the level of the approval committee that 2 members represent the state government vis-à-vis 6 representatives of the centre. The Central government appoints the development commissioner, under which the above-mentioned committee will work²⁵. The actual task of governing the SEZ will be given in the hands of development commissioner and 4 central government officials, who constitute the SEZ Authority.

Based on such an institutional structure several issues emerge. First, the state

²⁴ Rudolph, Lloyd and Susanne Rudolph. 2001. "Iconization of Chandrababu: Sharing Sovereignty in India's Federal Market Economy", *Economic and Political Weekly*, May 5, p. 1541.

²⁵ Refer to 'Chapter: IV: Development Commissioner', Section 11(1) in *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/ Asadha 2, 1927 (saka), p. 14.

governments that are the main players have very little representation. Gaining cooperation in this scenario could be difficult. All investment related issues like water, power etc. fall under the states' jurisdiction. The Development Commissioner will have to depend on the states willingly to cede their powers to him who represents the Central Government in the SEZ. This could be a problem. Hence, we notice 'a state-level variation in granting powers to the Development Commissioner depending on different legislations done by different states. For example, Maharashtra, Haryana and Gujarat being relatively more in tune to the central act have given substantial powers to the development commissioner. However this is not the case with politically strong southern states like Tamil Nadu and Andhra Pradesh'²⁶.

The Development Commission (DC) and the SEZ Authority mainly responsible for functioning of the SEZ, have no contact with the states because they are neither appointed by the states nor do they have any representatives. Given this backdrop, it is difficult for the zones to operate. A tussle of power between the centre and the states may emerge. In addition, many have also expressed a concern over the authority possessed by the development Commissioner. There is a concentration of power in the hands of Development Commission. Since the SEZ will have separate courts and security services, all three i.e. executive, legislature and judicial functioning would fall under the jurisdiction of DC.

This point towards the crucial fact that though the responsibility of establishing and maintaining SEZs have been transferred to the states, simultaneously equal amount of administrative powers have not been given.

b) Town planning: Goa Regional Plan-2021, a comprehensive land utilization plan, recommended scrapping of SEZs. The report gave several reasons according to which establishing SEZ would be detrimental to the economy of Goa²⁷. First, SEZ will put additional burden on the scarce resources available to the economy. Second, the

²⁶ See, Mukherji, Rahul & Aparna Shivpuri Singh. 2006. "Investing in the Indian Special Economic Zones: A Background Paper" at the Institute of South Asian Studies, National University of Singapore, 30 May.

²⁷ See, 'Scrap SEZ projects: Goa Task Force', *The Hindu*, 2007, December 31

employment that SEZ would generate, will lead to large-scale influx of migrants. This in turn will again increase the burden on land and resources. Further, migration also results in spread of diseases like HIV and often leads social problems such as increase in crime rate and prostitution. Third, it could lead to unplanned growth. Establishing SEZ requires building infrastructure in place first and then building such a zone. The present plan of the central government proposes superimposing a unit that has no link with the local economy. The result of this could be chaotic urban planning. Further, it could result in serious dislocation from the areas where SEZs are going to be established. This issue is discussed in detail in the fifth chapter. Consequently, state government of Goa demanded to scrap SEZs. This brings out why SEZs are not feasible for small states like Goa. However, it might not be true for all the states.

Prof. Pratap Bhanu Mehta also gives three problems in the SEZ Act, which devoid the act from the capacity to deal with rapid urbanization²⁸. While studying the Delhi Master Plan 2021, he says that the first problem is the inability to state who governs the Indian cities. Is it the municipality/panchayats or the state governments? According to him, SEZs 'only exacerbates the conundrum of jurisdictions that bedevils Indian cities'²⁹. Second, the government is giving many subsidies to the private developers. One of the reasons of giving subsidies is to enable the developer to build infrastructure for the region. However, in this case it might be a possibility that all the subsidies will be diverted from the cities to create infrastructure for the private developers. Third, private developers might succeed in creating workable towns with housing and infrastructural facilities in place. However, these will not be able to provide public goods on which the cities depend on. He gives the example of Gurgaon, where private developers while developing the city appropriated all the green spaces and public spaces to get maximum revenue out of the land. However, it did little for civic life.

²⁸ Mehta, Pratap B. 2008. 'A Bleak Urban Future', e-Newsletter published by Center for the Advanced Study of India University of Pennsylvania, Website: http://casi.ssc.upenn.edu/india/jit_Mehta.html , date of access: 01/04/2008.

²⁹ Ibid.

c) Financial Concern: The implementation of the SEZ policy is a risk, which the Ministry of Commerce and Industry has taken. This can be considered a risk because of the economic costs involved. The nature of the SEZ policy is such that the government in order to attract investments need to give a whole lot of incentives and concession to attract investments from domestic and global market. Chapter 2, gives a detailed list of concessions given by the central government. According to an estimate, there would be a loss of Rs 1,00,000 crores between now and 2010 on the account of lost revenues to both centre and the states³⁰. This amount does not include the indirect costs to the local economy.

Consequently, a lot of cautionary was issued by RBI, Ministry of Finance, IMF, World Bank and the Asian Development Bank. All these institutions expressed there reservations about giving tax concession and whether this can bring the required amount of export growth³¹. Infact a dispute between two cabinet ministers- the Union minister of Commerce Kamal Nath and Finance minister P. Chidambaram also surfaced and in the bureaucratic circle the zones gained the nomenclature of being 'zones of contentions'. Narendar Pani, in this connection observed that 'FM (Finance Minister) knows that he will be in trouble if the economy as a whole does not do well, while Commerce Minister's concerns are only with the export-oriented industries that are expected to benefit from SEZs'³².

This reflected the disagreement between different ranks of government over SEZ policy. At the same time, there is no guarantee on the returns from these SEZs. The Table 4.3, on the next page, shows the expectations made by the government and the actual benefit accruing on the SEZ account.

³⁰ Bidwai, Praful . 2006. 'The Great Land Grab', *Frontline*, Volume 23 - Issue 18, Sep. 09-22.

³¹ Dutt, Ruddar. 2006. 'Special Economic Zones', *Mainstream*, November 10-16, p. 19.

³² As quoted in *ibid*, p. 17

Table 4.3, Difference Between the Expectations and Actual Benefit made from SEZs

Issues	Projected	Actual state of affairs
1) Employment	15,75,452 (from 63 notified SEZ as on 06.08.07)	18,457 (from 63 notified SEZ as on 06.08.07)
2) FDI	1,748 million US \$	223.645 million US \$
3) Total investment	Rs. 1,00,000 crores (By March, 2008)	Rs. 70,416 crores (As on 31.12.07)
4) Export	Rs. 67,299.62 crore (By March, 2008)	Rs. 40,000 crores (upto December 07)

Source: Compiled from the information available on the Website: <http://www.sezindia.nic.in>, date of access: 06/08/2006 and 02/04/2008.

The table shows that SEZs have not been able to draw sufficient FDI or generate adequate employment. This trend could prove to be dangerous considering the amount, which has been forgone. However, gains from investments and exports are satisfactory.

In this context, one has to understand the dynamics of implementing SEZ policy or any NEP. Centre lacks adequate funds to augment states' development. It has therefore incurred risk to open a window of opportunities for the states to fend for themselves. The states can take advantage of the situation, make adequate progress, and at the same time enjoy newly gained autonomy. However, there is another side of this. Centre is forgoing a lot of revenue for establishing SEZs in the hope that the states will exploit the opportunity and make it a success.

Consequently, a reflection of this amount forgone by the centre would be in the overall transfers made to the states. If a state, fails to achieve adequate success through the SEZ policy, it would stand to miss on two accounts. One, it would not be able to adequately meet its need for resources because on one hand the centre funds would be insufficient and on the other it would not be able to get the same on its own. Second, if the states become economic defaulter it would lead to centre's interference into its functioning and therefore become less autonomous. Hence, a huge responsibility is in the hands of the states.

d) Political Dynamics: As already mentioned SEZ Act does not clearly demarcate the authority of the central and the states government in the functioning of the zones at the institutional level. However, a larger politics behind the scenes has the potential to effect the functioning of the SEZs. Role of states vis-à-vis the centre has tremendously increased. The central government therefore cannot afford to ignore or suppress the states. Consequently, it can make the formulation of clear-cut policies extremely difficult. For instance, the West Bengal government vehemently opposed the clause of flexible labor laws mentioned in the act. The Central government amended the law; however, the state governments continued to retain the clause in its earlier form.

Second problem relates to the coordination between various political parties in power. According to Prof. Rahul Mukherji and Aparna Singh, SEZs can be of considerable success if same party is ruling at both the centre and the state level. However, this can have quite an averse effect if parties ruling at the level of the states are different from those that are at the centre or if they are following different ideological stands³³. 'This can be seen in the case of Tamil Nadu where DMK is formulating policies regarding SEZ which hold little similarity to the directive given by the centre. It also needs to be explored, whether an opposition government in an investor friendly state is facing problems from the ruling party in the Centre³⁴ Can this explain why Gujarat has less number of SEZs as compared to Maharashtra and Haryana despite being an investor friendly state?

In addition to this, state level ministers have short time horizons. State level ministers form coalitions with the help of several fractions that often give instability to the ruling party. Their precarious political situation forces state leaders to think of the short-term effects of policies³⁵. Consequently, it would be difficult for the Chief Ministers to provide a stable political environment and proper coordination. According to Prof. Rahul

³³ Mukherji, Rahul & Aparna Shivpuri Singh. 2006. "Investing in the Indian Special Economic Zones: A Background Paper" at the Institute of South Asian Studies, National University of Singapore, 30 May.

³⁴ Ibid.

³⁵ See, Weiner, Myron. 1999. 'The Regionalization of Indian Politics and its Implication for Economic Reform', in Jeffrey D. Sachs, Ashutosh Varshney and Nirupam Bajpai (eds.), *India in the Era of Economic Reforms*, New Delhi: Oxford University Press, p. 287.

Mukherji, in 2005 'this could have been one reason why the Board deferred decisions about West Bengal, Tamil Nadu and Kerala, the three states facing elections within a short time frame'³⁶.

e) Land: For establishing SEZs, the most important component is that of Land. Land is a subject mentioned in the concurrent list. Besides the area that comes under forestation, all other aspects related to land such as tenancy, power, irrigation etc. is regulated by the states. Establishing SEZs therefore demand heavily on the states not just in terms of providing infrastructural facilities like power, water supply and roads but also demand greater level of town planning. Considering this, state level official are insisting that SEZs should be established in land owned by Centre, which involves less hassle. This is because, to demand states to establish SEZs in turn is like demanding them to take greater burden for augmenting growth of the country while the Centre limits itself to policy formulation. In this sense, a tussle to pass on the responsibility to one another between Centre and the states exists. Detailed discussion of the issues related to land is dealt in chapter 5.

Establishing SEZs:

This section examines the problems and issues that emerge with the actual functioning of SEZs:

a) Competition among states: The characterization of Indian 'Union of States' as 'cooperative' came as a response to the R.C. Wheare description of the same as 'quasi-federal'. According to Prof. Wheare, federalism is a two-tier machinery of government independent of each other in their own sphere of working. Since the powers of Central government could intervene and override the powers of the states, he argued that India is a 'quasi federation'. On the contrary, among others G. Austin argued that a pattern of cooperation and increased interdependence between the centre and the states exists. This

³⁶ Mukherji, Rahul & Aparna Shivpuri Singh. 2006. "Investing in the Indian Special Economic Zones: A Background Paper" at the Institute of South Asian Studies, National University of Singapore, 30 May.

does not mean that the federal character of a country is violated however, it might produce a strong Centre³⁷.

Indian federalism has demonstrated this wherein the states are administrative agencies of the Centre. Saez argues, that this 'concept of cooperative federalism continues to figure prominently in the government's portrayal of federal relations in India³⁸. For instance, according to the Ninth Five-Year Plan, the Planning Commission argued that cooperative federalism 'makes it possible to raise all available resources by the government at different levels in a coordinated way and channel them for use for the common good of the people'.³⁹

In this background of cooperative federalism, fiscal relations have always been an area of contention. The distribution of funds from the Centre has always been a matter of heated debate. In the recent times however, a decline in the transfers, assistance and loans given by the Centre did not create fervor opposition that was expected to, from the states⁴⁰. This is attributed to the alternative source of private financing available with the states since 1991. According to many scholars since 1991 crisis, a two-fold change has occurred⁴¹. On one hand, entry of private and foreign funds has gradually diminished the importance of the centrally transferred funds as a principle source of revenue for some states. On the other hand, the increased importance of private funds meant that the state would have to subject itself to the principle of competition operating in the market. This has fundamentally altered the relationship between different units of the government. According to Saez, 'the economic liberalization policies in the 1990s have promoted a change in federal relations from inter-governmental cooperation towards inter-

³⁷ See, Austin, Granville. 1966. *Indian Constitution: Cornerstone of a Nation*, Oxford: Clarendon Press, pp. 186-188.

³⁸ See Saez, Lawrence. 2002. *Federalism Without a Centre: The Impact of Political and Economic Reform on India's Federal System*, New Delhi: Sage Publications.

³⁹ See, *Ninth Five-Year Plan, 1997-2002*, Chapter 6, Government of India, Planning Commission, Vol. 1, New Delhi: Planning Commission.

⁴⁰ Saez, Lawrence. 2002. *Federalism Without a Centre: the Impact of Political and Economic Reform on India's Federal System*, New Delhi: Sage Publications, p. 145.

⁴¹ Ibid, and also see Rudolph, Lloyd and Susanne Rudolph. 2001. "Iconization of Chandrababu: Sharing Sovereignty in India's Federal Market Economy", *Economic and Political Weekly*, May 5, pp. 1541-1553.

jurisdictional competition among the states'⁴². The term inter-jurisdictional refers to the competition for resources taking place between the similar tiers (ie among different states) or localities within a region. This is in contrast with inter-governmental cooperative, which was not just vertical (centre-state-local) but also horizontal (between states), and thus taking place at different tiers of the government. There is lack of inter-jurisdictional cooperation, as enough opportunities of development are not provided to the grass-root level. Thus, different tiers of the government (Centre-State-Local) do not contend for resources.

The competition among the similar tiers is evident if we notice how some states have started to advertise themselves. This is not only limited to bureaucracy within the states but also is visible in how the state-level ministers are trying to do the same. They are seen on front pages, covers of news, magazines and television screens, making or breaking coalition governments, welcoming foreign statesmen and investors, dealing with natural disasters and domestic violence⁴³. The latest has been West Bengal Commerce and Industries minister Nirupam Sen, who has just been induced into the CPI (M) politburo decision to visit Germany to woo big industrialists⁴⁴. This visit was scheduled last year but was cancelled due to Nandigram fallout. Further, the publicity is being done in the context of other i.e. one state is trying to compete with the other to attract greater investments. For instance, Rajasthan Chief Minister Vasundhara Raje in a meeting with private investors said that 'I don't want Rajasthan to lag behind in these days of tough competition'⁴⁵.

This competition is especially true in the case of West Bengal, Karnataka, Tamil Nadu, Maharashtra and Gujarat. The websites of each of these states endorsing SEZs is a clear portrayal of the same⁴⁶. The covering e-page of these websites gives at a glance the list

⁴² Ibid, p. 135.

⁴³ Rudolph, Lloyd and Susanne Rudolph. 2001. "Iconization of Chandrababu: Sharing Sovereignty in India's Federal Market Economy", *Economic and Political Weekly*, May 5, p. 1541.

⁴⁴ Roy, Bidyut. 2008. 'After a week of Marx, new politburo member Niupam woos capital', *Indian Express*, April, 7.

⁴⁵ 'Vasundhara welcomes debate on SEZ', *The Hindu*, 2005 December, 08.

⁴⁶ See Websites: <http://www.portofmundra.com>, <http://www.navimumbaisez.com/overview.htm> and <http://www.mahindraworldcity.com/chennai>, date of access: 31/03/2008.

of benefits, the success made by each in terms of investment and employment, various tax incentives and relaxations made in labor laws. Surprisingly the pattern of all these websites is similar as if they are trying to compare one to another. Further, the enumeration of benefits is not only related to the specific units but glorify the entire state. For instance, following advantages of investing in Tamil Nadu and Maharashtra have been listed on the website of the respective Industrial Development Corporation as shown in the table 4.4 below:

Table 4.4, Advantages Mentioned to Attract Foreign Investors

Tamil Nadu	Maharashtra
<ul style="list-style-type: none"> • Fastest growing State Economy in India • One of the top three recipients of Foreign Direct Investment (FDI). • Matured manufacturing sector. • Fast emerging as the IT happening destination • Stable political climate • Pro-active and investor friendly Government with transparent decision-making approach. • People's adaptability to change. • Most urbanized state • Ranks No.1 in availability of skilled manpower in India • Excels in terms of Human Resource, Infrastructure and Labor Relations. • Well-qualified, skilled, disciplined, productivity oriented and English speaking work force. 	<ul style="list-style-type: none"> • Most Urbanized State: 43% (India 28%) • Highest FDI approvals in the Country • 50%Of India's Foreign Trade is Handled By Seaports & International Airport • 900+ Institutions provide 169,000 Technical Manpower • Urban Population > South Korea. Only 15 Countries have higher Urban Population • Average Annual Growth in Last 10 Years : 7% (9.3% last 3 years) • 9.4 % of Country's Population (Produces 19% of National output) • 67% Share of Younger Population(Below 34 years)

Source: Advantage of Tamil Nadu', Website: <http://www.tidco.com/advantamil.html>, date of access: 31/03/2008 and see 'Snapshot of Maharashtra', Website: http://www.midcindia.org/mah_overview/leadInvDest.php, date of access: 31/03/2008.

Aseema Sinha however, contradicts this widely held belief among many scholars, journalists and investors that the competition surfaced after 1991⁴⁷. According to her, competition always existed. What has changed post-reforms is the nature of contention. In the pre-liberalization period, the primary mode of regional competition was vertical

⁴⁷ See, Sinha, Aseema. 2004. 'The Changing Political Economy of Federalism in India: A Historical Institutional Approach', *India Review*, Vol. 3, no.1, January, pp. 25-63.

through the national state; now the primary mode is horizontal competition between the regional states themselves⁴⁸. The states in pre-reform era, tried to attract private investment largely from NRIs, gave subsidies that matched those of central government, struggled for setting up of Public Sector firms in their respective states and getting both political and economic resources from the Centre. Even the Planning Commission, designed as an autonomous organization, was forced to deal with the intense competition among states⁴⁹. Then what has changed? According to Sinha, the real change from the past one and a half decade has been in the nature of competition. These changes brought about through pursuit of New Economic Policies like Special Economic Zones have fundamentally altered the federal relations and to some extent are irreversible. The changes are⁵⁰:

- Emergence of converging policy discourse: Pro-leftist, Hindu rightist or liberal parties ruling in different states, have all taken on to a neo-liberal policy discourse. Each exalts the virtues of attracting FDI, industrialization, giving incentive to the private sector and achieving export led growth irrespective of their often-conflicting ideological inclinations. Hence, a convergence in terms of the policies adopted and the output expected by different states has emerged. According to Loraine Kennedy, such a convergence emerged, because the states since 1991, realized the need to revamp their 'industrial and infrastructural policies and to create a more conducive environment for private investment. This led to similar promotional strategies and incentives adopted in many states, and hence to increasingly overt inter-state competition'⁵¹. This scenario is different from the Nehruvian times when the Centre imagined the Indian state to occupy commanding heights of the economy and Planning Commission laid down the objectives. These were often not acceptable to other state level parties. However, in recent times, the differences existing between various state level parties about the objective and nature of growth strategy seems to have mitigated. For instance,

⁴⁸ See, Sinha, Aseema. 2004. 'The Changing Political Economy of Federalism in India: A Historical Institutional Approach', *India Review*, Vol. 3, no.1, January, p. 34.

⁴⁹ Ibid, p.36.

⁵⁰ Op. cit., Aseema Sinha, 2004, p. 42

⁵¹ Kennedy, Loraine.2004. 'The Political Determinants of Reform Packaging: Contrasting Responses to Economic Liberalization in Andhra Pradesh and Tamil Nadu', in Rob Jenkins (ed.), *Regional Reflections: Comparing Politics Across Indian States*, New Delhi: Oxford University Press, p. 33.

West Bengal after pursuing socialist agenda for four and half decades has now embraced policy of liberalization. Example of two states will substantiate the point. Telugu Desam Party (TDP), since its formative years had a strong 'welfarist and redistributive' orientation. With Chandrababu Naidu taking over the reins of the state the ideology and policies of the parties were altered. His public discourse has become explicitly supportive of not only markets, but global economic integration in general, as a means to achieve growth and social development⁵². Similarly, Kerala, a state ruled by communist party that has aggressively followed redistributive measures has now started to liberalize and open up the state in order to bolster the industrial sector⁵³. In the case of adopting SEZ a capitalist policy, Andhra Pradesh is now leading with highest number of SEZs, which includes 70 SEZs- formally approved, 3 – in principle approved and 53 notified SEZs. Similarly Kerala has 11 formally approved, 2 in-principle approved and 8 notified SEZs as on 24/01/2008⁵⁴. Hence, the general point is that many state level parties, which at some point did not approve of liberalization, have after the reforms increasingly centered their policy discourses on similar issues related to the same. Further, it also throws light on how all the states have been drawn into the compulsion of competition.

- The rising politics of numbers and ranking: Since drawing the attention of the potential investors has become central to all the states, use of statistical data to rank one state over the other has also become a common trend. This ranking is done by private agencies (like Centre for Monitoring the Indian Economy), governmental agencies (like Credit Rating Information Service of India Ltd-CRISIL) and various business journals (like- India Today⁵⁵, Business Today and Quarterly Business Manager etc). Prosperity and budget, health, investment environment, agriculture, education, consumer markets and infrastructure are

⁵² Ibid.

⁵³ Government of Kerala, Industrial Policy, 1991 in ⁵³ Kennedy, Loraine.2004. 'The Political Determinants of Reform Packaging: Contrasting Responses to Economic Liberalization in Andhra Pradesh and Tamil Nadu', in Rob Jenkins (ed.), *Regional Reflections: Comparing Politics Across Indian States*, New Delhi: Oxford University Press, p. 33.

⁵⁴ Source: <http://www.sezindia.nic.in> , date of access : 31/03/2008.

⁵⁵ See, 'The State of the States: India's Best and the Worst States ', *India Today*, 6 August, 2004. Also, see <http://www.rediff.com/money/2005/nov/12guest2.htm>, date of access: 31/03/2008.

some of the criterion used to rank states. In the case of SEZs, different SEZ units explicitly represent in figures the investments made especially by foreign companies and the employment generated. News like 'AP, Maharashtra lead in SEZ race'⁵⁶ is commonplace. According to Sinha, this has led to a politics of numbers and ranking between different states where each tries to score a point over the other. This ranking politics is important because it creates a 'demonstrative effect'. That is to say, such ranking can produce spillover effect in terms of encouraging potential investors even if the ground realities differ from facts projected. She explains this by quoting the vice-president of Mahindra Ford Ltd. who in an interview said 'we looked at Gujarat as a possible choice because the state government had recently declared that some auto majors had decided to invest in Gujarat, and GM (general motors) was already there'⁵⁷. Further, since ranking and numbers are so important, the role of media in terms of selling and advertising states also become important. Chief Ministers, Industry Ministers and even bureaucrats consciously seek out the media to advertise their industrial policies and achievement and explicitly compare themselves with their competitor states⁵⁸. Through media, each state is trying to build a particular image- through various cultural motifs, business like language and symbols. This then involves giving considerable information about the state's objectives, achievements, plans, benefits and policies. This in a sense has led to a degree of transparency and provided an opportunity for public scrutiny.

- Trans-border regionalism: With the increased importance given to the foreign and private investments, states have now started interacting with sub-national, national and international actors directly. This privilege was initially reserved for the Central government by the article 253 of the constitution relating to the entry into international treaty. According to the SEZ Act of 2005, clause 49 any rules and regulations of the central government shall not apply to SEZs. Therefore, we see in the case of SEZs, states are able to strike international treaties. For

⁵⁶ See, Gupta, Monica. 2006. 'AP, Maharashtra lead in SEZ race', July 26, website: <http://www.rediff.com/money/2006/jul/24sez.htm>, date of access: 31/03/2008.

⁵⁷ As quoted by Sinha, Aseema. 2004. 'The Changing Political Economy of Federalism in India: A Historical Institutional Approach', *India Review*, Vol. 3, no.1, January, p. 47.

⁵⁸ Ibid.

instance, Tamil Nadu government with the help of Singapore has set up an SEZ unit (Tidco). Based on the comprehensive economic cooperative agreement (CECA), Singapore will also help in setting up SEZs in Maharashtra⁵⁹. The main reason for this has been that since liberalization, policies that are being formulated need active involvement of the states. With the central government, partially retreating as the main engine of various growth strategies, the responsibility and the need to have direct dealing with states involved in the actual process has increased. Therefore, we often see states making dealings with international bodies, which often involve bypassing the centre. This in future can fundamentally change the federal balance of power. At present, it had given the state governments the authority to not just engage in a foreign project but also negotiate and establish the rules of the games. Consequently, states are now partially contributing in shaping the foreign economic relations.

- Concessional competition: According to Rudolphs, growing interstate competition can take either of two forms. Race to the top or race to the bottom. 'Race to the top takes the form of attracting private investment by providing skilled and committed labor force and good work culture, good infrastructure, especially power, transport and communication and good governance. Race to the bottom is driven by competition to provide a variety of concessions that, allegedly, will attract by force the state to forgo needed revenues'⁶⁰. As already shown in the first chapter, Indian states lack the necessary criterion to attract private capital by projecting themselves as desirable investment destinations. Consequently, a number of concessions are provided to the investors by the state governments. In the case of SEZ, the central government has provided a lot of concessions and incentives to the SEZs developer. However, to provide greater leverage to SEZs, state governments have gone a step further. They have relaxed a number of rules and given special privileges through modifying the laws that fall under the state list. For instance, the Central government has amended the clause pertaining to flexible labor laws in the SEZ Act. However, most states

⁵⁹ See, 'Singapore to help India set up SEZs', *The Hindu*, 26th September 2006.

⁶⁰ Rudolph, Lloyd and Susanne Rudolph. 2001. "Iconization of Chandrababu: Sharing Sovereignty in India's Federal Market Economy", *Economic and Political Weekly*, May 5, p. 1546.

went ahead and amended various laws such as – Contract Act, Industrial Dispute Act and declaration of SEZ as a public utility region, hence banning the strikes to provide flexible labor laws. Similarly, taking environmental clearance comes under state subject. State governments are allowing developers to bypass the environmental impact assessment⁶¹. Hence, what is being witnessed is a race to the bottom. However, this is not uniformly true for all the states. Some states like West Bengal, Kerala and Maharashtra are faring better than others. Another trend that can be observed is the variation in the concession offered by different states. Given the intense competition for investments, every state is trying to provide greater concessions as comparison to the other. For example, Maharashtra was the first state to amend contract laws, Industrial dispute Act etc. This suit was soon followed by a number of other states like Tamil Nadu, Gujarat and Karnataka. Such a trend could prove to be a problem.

b) Regional Disparities in the spread of SEZs: Colonial rule in India for nearly 200 years created enormous regional disparities between different administrative units. Consequently, one of the main objective of the centralized planning in India since independence was to bring economic parity between different states. However, 50 years of efforts did not produce the desired result. Post reforms, several studies indicate that divergence between the states has increased⁶². A need to look into regional disparities is very important. We are a federal democracy in which the constitutional division of powers between the centre and the states makes the states pre-eminent in many areas and co-equal with the centre in others⁶³. Further, with liberalization, the central government has retreated to some extent and the state governments instead have assumed greater powers and responsibilities. In this situation, an assessment of the state governments'

⁶¹ For instance Andhra Pradesh government in the Policy frame work for Special Economic Zones (SEZs) in clearly specifies in point 7.2 that 'SEZ does not require Environment Impact Assessment (EIA) approval', Website: www.sricity.in/APSEZ_Policy.pdf, date of access: 01/04/2008.

⁶² See, Rao, G. M., R.T. Shand and K.P. Kalirajan. 1999. 'Convergence of Income across Indian States: A Divergent View', *Economic and Political Weekly*, March 27, pp. 769-778. Also see Ahluwalia, Montek S. 2000. "Economic Performances of States in Post- Reforms Period", *Economic and Political Weekly*, 6th May, pp. 1637-1648.

⁶³ Ahluwalia, Montek S. 2000. "Economic Performances of States in Post- Reforms Period", *Economic and Political Weekly*, 6th May, p. 1637.

performance is very crucial to determine the progress of the nation. For federalism, it also has a pedagogic value of bringing out the lessons, which non- performing or poorly performing state can learn from successful states. Most importantly, disparities can put a lot of strain on federal structure and in longer run can prove to be dangerous for the unity of the nation. In Pakistan, the cause for independent Bangladesh gained weightage from the fact the East province was far poorer than the Western provinces of Punjab or Sindh⁶⁴. Hence, whenever a growth strategy is considered, its implication in terms of regional disparity has to be assessed. The table 4.5 below shows variation between annual growth rates of Gross State Domestic Product (GSDP) of different states.

Table 4.5, Variation of Annual Growth Rate of GSDP of Different States

State-wise Annual Growth Rate of Gross State Domestic Product (GSDP) in India {(At 1993-94 Constant Prices) (2001-2002 to 2004-2005)}				
(% Growth Over Previous Year)				
States	2001-02	2002-03	2003-04	2004-05*
Andhra Pradesh	4.9	3.8	9	6.4
Arunachal Pradesh	4.7	5.2	7	1.7
Assam	6.1	4.7	5.5	5.9
Bihar	-9.4	15.7	-9	12.1
Jharkhand	4.3	7.4	4.3	5.3
Gujarat	8.3	7.5	15.1	5.1
Karnataka	1.8	4.3	4.8	10.2
Kerala	2.5	8.3	10.7	8.8
Madhya Pradesh	8.7	-6.3	16.2	3.4
Chhattisgarh	14.1	1.6	16.8	NA
Maharashtra	5	8.3	7.9	8.4
Orissa	5.6	0.6	15.3	8.9
Punjab	2.2	2.4	6.3	5.4
Rajasthan	9.4	-6.9	26	0.6
Tamil Nadu	-2.2	3	3.6	8.7
Uttar Pradesh	3	5.7	4.6	4.8
West Bengal	7	7.5	7.1	7

Abbreviation. : NA : Not Available.

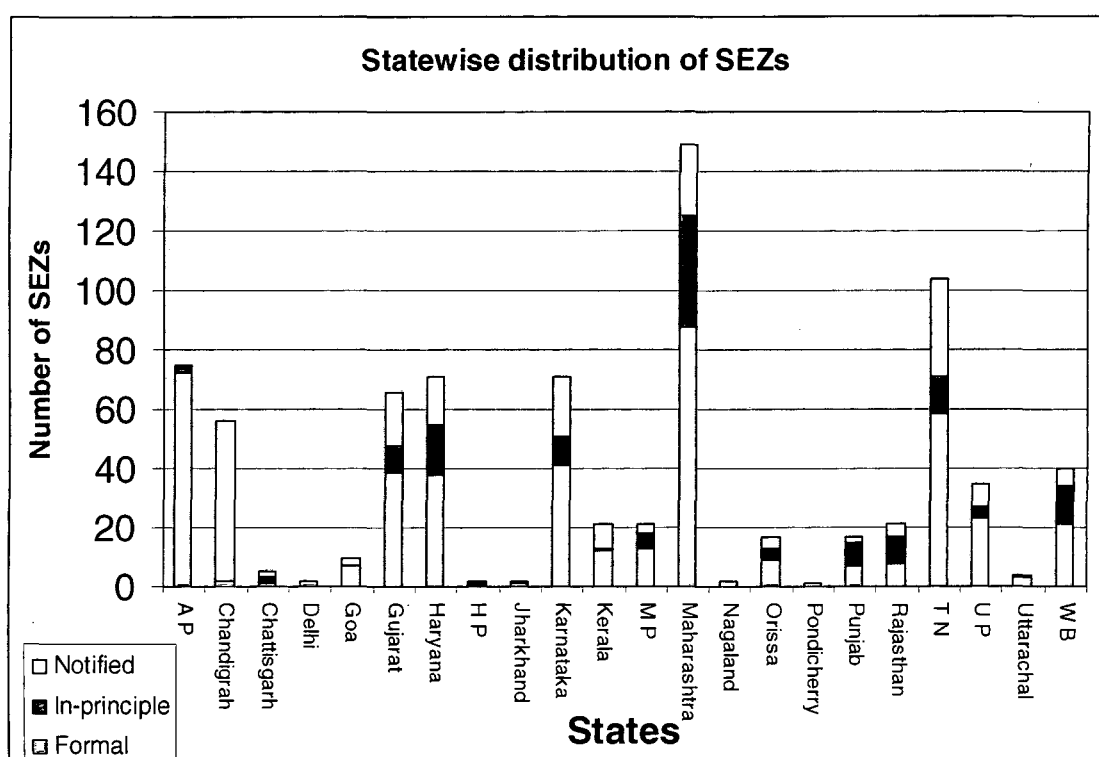
Note : * : Position as on 21.07.2006.

Source : Ministry of Agricultural, Government of India.

⁶⁴ Mozoomdar, Ajit.1995. 'The Political Economy of Modern Federalism', in Balveer Arora and Douglas V. Verney (eds.), *Multiple Identities in a Single State: Indian Federalism in Comparison Perspective*, New Delhi: Konark Publishers Pvt Ltd, p. 221.

According to many scholars, one of the main reasons for regional imbalance in the post reform period is due to the increased flow of private investments⁶⁵. Further, a pattern is observed in the flow of these private funds. According to Ahluwalia, states that are more competent in providing factors that attract investors –good infrastructure and governance, skilled labor and work culture etc- get the maximum corporate funds. This pattern can be seen in the case of SEZs also states of better investment climate are attracting more funds for setting up SEZ. The chart 4.1 below shows the number of SEZs established in each state.

Graph 4.1, State-wise Distribution of SEZs

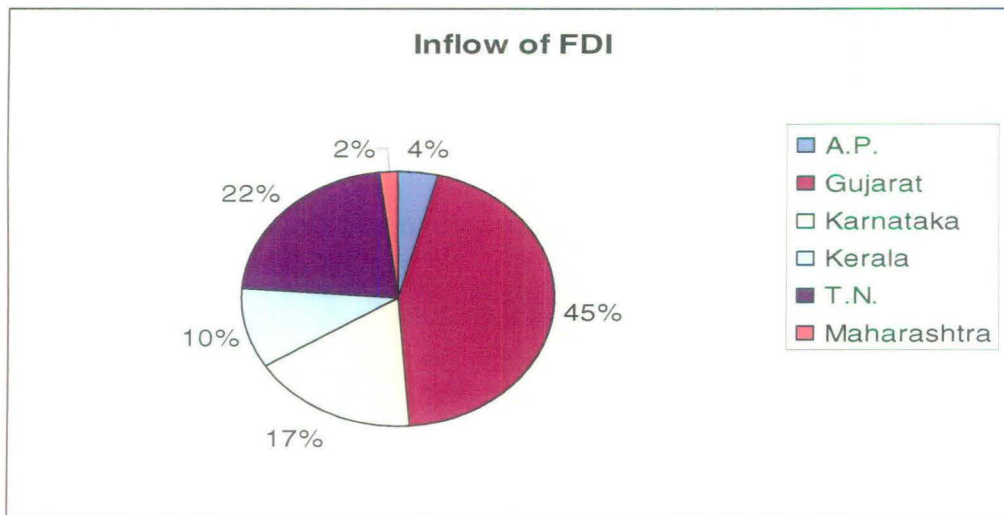


Source: Compiled by the information available on the Website: <http://www.sezindia.nic.in/HTMLS/Statewise-distribution-approved-SEZs.pdf>, date of access: 02/04/2008.

⁶⁵ See, Rao, G. M., R.T. Shand and K.P. Kalirajan. 1999. 'Convergence of Income across Indian States: A Divergent View', *Economic and Political Weekly*, March 27, pp. 769-778, Ahluwalia, Montek S. 2000. "Economic Performances of States in Post- Reforms Period", *Economic and Political Weekly*, 6th May, pp. 1637-1648. Also see, Saez, Lawrence. 2002. *Federalism Without a Centre: the Impact of Political and Economic Reform on India's Federal System*, New Delhi: Sage Publications, p. 145.

The states that have a large number of SEZs, is consequently able to attract a large amount of private investments. The pie chart on the next page, shows the total amount of FDI flowing into the SEZs in India states.

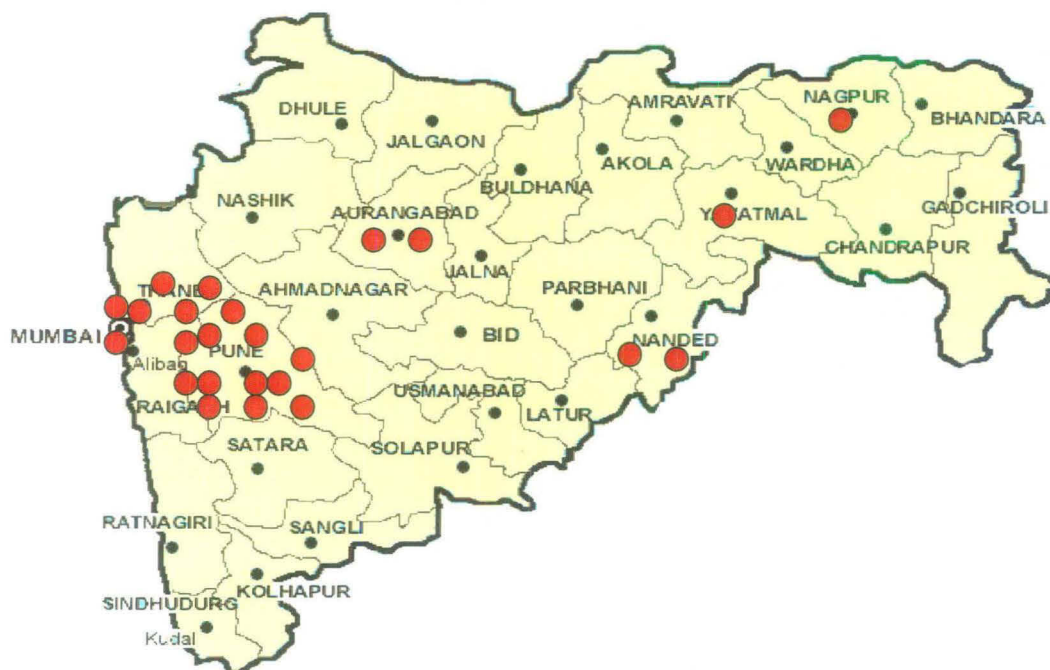
Chart 4.1, inflow of FDI in different states



Source: 'Investment proposed and Made in SEZs notified under SEZ Act', Website: <http://www.sezindia.nic.in/HTMLS/employment-investment.htm>, date of access: 02/04/2008.

From all the above, what is evident is that investments have been made mainly in those states, which have favorable investment climate. Three categories can be observed in terms of annual growth rate of GSDP, number of SEZs established and inflow of FDI in these SEZs. First is that of high performing states, which include- states like Maharashtra and Gujarat followed by average performing states like Tamil Nadu, Kerala, West Bengal, Andhra Pradesh and Madhya Pradesh. The last category is that of laggard states like Orissa and Uttar Pradesh. States like Bihar have to open their account of setting up an SEZ. Hence, a clear regional disparity is seen. Interestingly regional disparity is not only between different states but also between different districts within the same state. For example, Maharashtra has a concentration of SEZ in and around Mumbai and Pune. Southern and Northern districts within Maharashtra do not have any SEZ establishment as shown in the Map 4.1, on the next page:

Map 4.1, distribution of SEZs within the state of Maharashtra



Source: Compiled from the data available on the Website: <http://www.sezindia.nic.in>, date of access: 02/04/2008. Note: the dots representing the SEZs, may not be latitudinally or longitudinally accurate but are situated in the respective districts.

Such a situation creates a further problem. One of the most important reasons for setting up the SEZ given by government of India is to develop infrastructure. However, private investments come only to those states where the infrastructure is already good. The Union minister of state for power, Jairam Ramesh while expressing his concern stated, “a lot of SEZs would come up in infrastructure-rich areas. The backward States may get some SEZs on paper, but not the real significant ones”⁶⁶. For instance, according to CII study has shown that proposals for as many as a dozen SEZs have come up around Delhi and the National capital region, including in places such as Gurgaon and Panipat in Haryana and Ghaziabad⁶⁷. Consequently, regions with good infrastructure get more investments with which they further build on their existing capacity. Contrary to this, laggard regions or states fail to achieve the same, thus further aggravating divergence.

⁶⁶ See, Ramakrishnan, Venkitesh. 2006. “Interview with Union Minister Jairam Ramesh”, *Frontline*, 20 October.

⁶⁷ ‘India SEZ Summit 2006: Driving Investments and Exports: Building Growth Centres’, Confederation of Indian Industries, New Delhi, Website: http://cii.in/documents/WTO/SEZ_Background_Paper.pdf, date of access: 1/01/2008.

The point being made is not that growth pattern should be uniform in all the states. States have different capacities and will develop accordingly. What needs to be emphasized is that growth should accrue to all, even to those states or regions, which are left behind to achieve balanced regional development. This underlines the responsibility of the states as well as the central government to reduce the divergence both by ensuring that private investment reaches the remotest of areas and where it fails, it is substituted by public investments.

Another problem related to imbalanced regional development, is that of reallocation of the units. Developers, which set up units in the SEZs pay no taxes, no import duties and avail all the benefits as compared to any other domestic market producer who does not own any establishment in the SEZ. Consequently, any rational businessperson would conclude that he will be better off in a SEZ. This is resulting in the problem of re-allocation of established units to SEZs set up in already developed regions. It might also hamper the growth of tax paying small and medium scale industries not located in SEZs.

Lastly, many argue that SEZs can lead to a new form of inequality within the states through a system of inclusion and exclusion. Those living within SEZs will enjoy inclusion, in the process of economic growth. This is because the SEZs will be able to provide better governance, proper infrastructure and other amenities. Hence, the population within SEZ would be able to attain a high standard of living. Contrary to this exclusion will be faced by those staying in the surrounding region outside the SEZ, which would be a chaotic uncharted area. The SEZ might even get a small proportion of this excluded population that will commute daily to SEZs to provide menial labor. Hence, it will negate the principle of inclusive growth.

c) The Role of the Third Tier: The need and desirability of a third tier has resounded in the corridors of Indian Parliament since the days of independence. Mahatma Gandhi, a fervor supporter of Panchayati Raj, believed that through political and administrative decentralization the economic conditions of the country could be improved. Further, it had the potential to hold the country together as a unit and lead it to the path of progress.

However, any explicit system for local self-government like Panchayati Raj was not incorporated into the constitution. Some concession for this idea was made by incorporating the guidelines for 'promoting the local government', in Directive Principles of State Policy. Nevertheless, the need for such a tier was repeatedly felt because of three main reasons:

- The third tier could ensure participation of large number of people at the grass-root level in the process of democratic government. It could, thus contribute in creating proximity of the local masses with the power centres.
- There was need to lessen the burden of state administration and cost through decentralization. According to Prof. Balveer Arora, 'the pressure to decentralize state bureaucracies came from the Centre, and was promoted by the realization that they were consuming an inordinately large share of resources intended for developmental programmes, which were therefore not reaching the intended beneficiaries'⁶⁸. Therefore, decentralization allows the resources to accrue to people for whom it is meant, directly.
- Through the third tier and more so through panchayats it was hoped that participation of people at the grass root level in agriculture and industrial production could be achieved. This would contribute in the national development.

Hence by a series of initiatives taken by Rajiv Gandhi and later by the 73rd and the 74th amendment made in the constitution, Panchayats and other sub-state structures came to be given a constitutional status of a 'third tier'. However, the state governments were skeptical about the 'third tier' from the beginning. According to many, it was a measure taken by the central government to divert the attention from the real issue of 'centre-state decentralization'. Some even believed that through this, the Union could further centralize by engaging directly with the local bodies for administrative purposes. Consequently, this skepticism reflected in the lack of powers, responsibilities and resources transferred to the third tier by the state governments.

⁶⁸ Arora, Balveer. 2001. Intergovernmental Relations in the Indian Union', in Norman Levy and Chris Tapscott (eds.), *Intergovernmental Relations: The Challenges of co-operative Government*, Cape Town: IDASA, p. 247,

As already seen, 1991 reforms brought in its train a changed relationship between the centre and the states. However, the same is not true in the case of state-local relations. Even those states that have comparatively succeeded in setting up local self-government did not show improvement on this front, post reforms. This might be a reflection of the reluctance on the behalf of the state governments. In the case of SEZs, the existence of the third tier has been completely ignored. Based on the SEZ Act of 2005, clause 49 and the Article 243 (q) of the constitution, the resident population of a Special Economic Zones can be denied any form of local governance. Article 243 (q) states, 'a Municipality under this clause may not be constituted in such urban area or part thereof as the Governor may (...) by public notification, specify to be an industrial township'⁶⁹. This is a direct confrontation between the Directive Principles of State Policy Article 40⁷⁰ on one hand, which talks about giving a platform for people's participation in the government through some form of local self-government by an amendment Act (74th) on the other. This problem assumes a great magnitude if the sheer size of SEZs are taken into consideration. For instance, the Reliance group planning to establish SEZ in Navi Mumbai, would cover an area of about 1,223 hectares. Reliance expects to house 1 million residents and play host to 2 million others who would commute daily to their SEZs⁷¹. Similarly, there are other SEZs, which cover more than 1000 hectares of land and consequently will have a large resident population like the Mundra Special Economic Zone Limited, Gujarat (4,498.757 hectares) and NMSEZ, Maharashtra (1250 hectares) etc⁷².

The absence of the third tier, then throws up a whole lot of issues relating to the governance of the zones. The most important are the developmental responsibilities given to panchayats and municipalities by the 74th amendment. Though not all state governments have succeeded in transferring these powers and responsibilities to the third tier, but with SEZs all of these will be de facto transferred to or managed by SEZ

⁶⁹ Website: <http://tnsfc.tn.nic.in/article-243.htm>, date of access: 1/04/2008.

⁷⁰ Article 40 states, 'The State shall take steps to organize village panchayats and endow them with such powers and authority as may be necessary to enable them to function as a unit of self government.

⁷¹ Jishnu, Latha and Feroz Ahmed. 2006. 'Sovereign States?', *Businessworld*, 13th November, pp. 44-46.

⁷² See, 'List of Formal Approvals granted under the SEZ Act, 2005', Website: <http://www.sezindia.nic.in/HTMLS/approved-sez.htm>, date of access: 1/04/2008.

Development Authority (SDA). This SDA as already mentioned will constitute of a Development Commission, four central government representatives and two developer representatives.

In the case of small SEZ units this arrangement would be beneficial, as it could lead to speedy and efficient management of the zone. However, in case of those SEZs encompassing a large population, it can create problems. The table on the next page shows distribution of functions to the panchayats. Within the SEZs, all of these responsibilities and in the case of urban areas, all municipal functions would be devolved to SDA⁷³. However, this authority does not constitute of a single elected representative of the resident population. Lack of elections, means that accountability and transparency in the working of the SDA will not be ensured. Since certain functions like water and electricity supply would be delegated to private companies who would have a monopoly this issue becomes more pertinent. Further, nothing in the Act states what happens if the service provider falters in providing these services? For instance, 'unlike a municipality, the developer is not obliged to provide services to all citizens', 'how then would a resident deprived of such services seek to enforce such a right?'⁷⁴. In addition, social welfare functions in these zones would remain largely neglected as the state or central government will have no jurisdiction over such territories.

The SEZ unit will have its own internal security system, which is the responsibility of the developer and separate judiciary system for speedy deliverance of justice. However, the power of both the above-mentioned authorities can come into conflict with those existing outside the zone. For example, can the police challenge the jurisdiction of internal security system? Similarly, will the verdicts given by the judicial wing within the SEZ be applicable outside the zone as well? The Act is also silent about situations where a clash between state government authorities and SEZ authorities emerge.

⁷³ For instance, the Gujarat SEZ regulation Act of 2007, dated April 2, mentions a list of functions of SDA, which were under the urban-rural self government. These include among others providing vaccinations, issuing of birth and death certificates, registration of marriages, removing obstructions and projections on public streets and other public places and naming or numbering of street and of public places etc - Notification: Gujarat Special Economic Zone Development Authority Gandhinagar, dated 2-4-2007, Website: <http://imd-gujarat.gov.in/gr/g/SEZ-Regulation-2007.pdf>, date of access: 01/04/2008.

⁷⁴ Jishnu, Latha and Feroz Ahmed. 2006. 'Sovereign States?', *Businessworld*, 13th November, p. 46

Table 4.6, List of Developmental Responsibilities for Panchayats:

Development Area	Subjects
1. Land	Land improvement, implementation of land reforms, land consolidation and soil conservation (2)
2. Water	Drinking water (11), minor irrigation, water management and watershed development (3)
3) Electricity, power and energy	Rural electrification and distribution of electricity (14), non-conventional energy sources (15), fuel and fodder (12)
4) Agriculture and fisheries	Agriculture (1), fisheries (5), animal husbandry, dairying and poultry (4), social/farm forestry (6)
5) Industry	Small-scale industries, food processing (8), khadi/village/cottage industries (9)
6) Oil, mines and minerals	None
7) Trade, commerce	Markets and fairs (22)
8) Transport and communications	Roads, culverts, bridges, ferries, waterways and other means of communication (13)
9) Education	Education, including primary and secondary schools (17), technical training and vocational education (18), adult and non-formal education (19)
10) Information and Broadcasting	Libraries (20), cultural activities (21)
11) Public Health	Health and sanitation, including hospitals, primary health centres and dispensaries (23)
12) Social welfare and security	Poverty alleviation programme (16), family welfare (24), women and child welfare (25), social welfare (26), welfare of weaker sections (27), public distribution system (28)
13) local government and co-operative	Maintenance of community assets (29)

(The entry numbers of the Eleventh Schedule are given in the brackets)

Source: Arora, Balveer. 2001. Intergovernmental Relations in the Indian Union', in Norman Levy and Chris Tapscott (eds.), *Intergovernmental Relations: The Challenges of co-operative Government*, Cape Town: IDASA, p. 250.

The third tier is important as it leads to political decentralization. Further, it also leads to social and economic decentralization through vertical and horizontal dispersal of power. In this sense, the third tier has to some extent come to represent sections of the society often marginalized. For instance, customary panchayats, which makes it mandatory to elect a women or a persons from SC and ST category. SEZs with large population, having no access to power through panchayats or municipalities would provide no outlet to this marginalized section.

Lastly, the role of villages in fostering national integration and social cohesion is very vital. Further, the role of local governments in providing a training ground for future

politicians is also vital. However, huge SEZs managed and controlled by different private corporations for a long time can create divided loyalties among the resident population. Jishnu Latha gives the example of Jamshedpur Tata, a century old industrial township run by Tata Steel. Tata provides all the civic amenities within the township. Recently, the government of Jharkhand tried to foist a municipal corporation in the township to ensure local democracy, a move that was opposed by majority of the resident population⁷⁵. Therefore, this issue needs to be considered for all multi-product large size SEZs. To conclude, the absence of third tier within the SEZs has left a lacuna for a proper administrative authority. The SEZ Act attempts to fill this vacuum. However, much needs to be done on that front. It is necessary to formulate laws that are more competent and have a clear-cut demarcation of powers and authorities. Most importantly, it is exigent to bring various provisions of the Act in line with the spirit and character of the constitution.

Hence, to conclude, it is evident that the policy of SEZ has come to represent the move from the centre to the states. The contribution of political process cannot be overlooked. For Prof. Arora post 1990s, India has come to represent, from a reluctant to a robust federalism⁷⁶. The autonomy enjoyed by the states is unprecedented. Participation and assertion of states in decision as well as policy-making, especially in matters that affect them crucially is evident. However, certain issues need to be considered if the health of the federal polity has to be maintained. First, transfer of powers and resources and not just responsibilities, from the centre to states should be made so that states become more independent. Second, for any policy of economic growth to succeed in a federal polity, it is very important to achieve coordination and cooperation between different tiers. This is very important for smooth functioning of SEZ. Similarly, to mitigate concessional competition between different states it is important to ensure cooperation at different levels- between states and between centre and the states. Third, a need for centre to come forward not just as a coordinator but also as a regulator to rectify defaults is essential.

⁷⁵ Ibid.

⁷⁶ See, Arora, Balveer. 2006. 'From Reluctant to Robust Federalism', in Mary E. John, Praveen Kumar Jha and Surinder S. Jodhka (eds.), *Contested Transformations: Changing Economies and Identities in Contemporary India*, New Delhi: Tulika Books.

Lastly, the concentration should not just be at the level of centre and the states. In the case of SEZs, the third tier that forms a vital part of Indian democracy has been completely ignored. This could lead to a reversal of trends. There is an urgent need to look into these issues especially when the protests against the SEZs have become so vocal. However, much is not lost. The reforms, as seen have evoked the very agency of the states and that this agency can fundamentally alter the structure. Hence, a lot depends on the states' performance.

The next chapter looks at the larger question of what liberalization and within it the policy of special economic zones holds for federalism as a principle of accommodation. Does it lead to social cohesion and harmony of interest within the society? If not, then how can SEZ, as a growth strategy, be worked out as a policy of 'inclusive growth' in a federal polity. It attempts to do so by dealing with a number of issues such as land, labor and environment.

Chapter-5

Inclusive Growth

Federalism is both a territorial as well as a non-territorial project. The former refers to installing a structure of government and the latter refers to designing rules for co-existence. This chapter deals with federalism as a non-territorial project. It denotes establishing a socio-economic structure and a system of distributive justice in the society as envisaged by the people and leaders to stay together as a country¹. The aim is to ensure liberty and harmony of interest of diverse groups (socio-cultural, linguistics and economic) within the society and in turn maintain 'unity in diversity'. Mere legislative enactments favoring decentralization or the holding of regular elections to various bodies as enshrined in the Constitution, each of which is necessary, do not guarantee the existence of decentralized polity, much less of a decentralized social order². Therefore, for establishing a genuine decentralized order one needs to go beyond the legal-political terms and translate it into socio-economic terms. Issues like economic disparity, distribution of benefits, access to necessary and scarce resources and opportunities are equally important in manifesting decentralization as the distribution of powers and responsibilities between different tiers of the government. The chapter explores this aspect of Indian federalism through the case study of Special Economic Zones.

Special Economic Zones are envisaged as engines to bolster the economic growth. They are seen as one of the main strategies to achieve an average of 9 % growth rate mentioned in the 11th plan period (2007-2012)³. However, the aim of the plan is not just to achieve rapid growth but also to focus on inclusion. It becomes pertinent therefore to assess the character of the SEZ policy in this context. This would not only bring out how 'inclusive' the SEZ policy is but also help in examining decentralization in socio-

¹ See, Kothari, Rajni . 1989. 'Decentralization: the Real Issue', *Monthly Public Opinion Surveys*, Vol. XXXIV, Nos. 1 & 2, Oct. & Nov., pp. 3-9.

² See, *ibid.* p. 6.

³ "Towards a faster and More Inclusive Growth, An Approach to the 11th Five Year Plan", Government of India, Commission Yojna Bhavan, New Delhi, 9th December 2006, Website: www.planningcommission.gov.in, date of access: 06/08/07.

economic terms and testing the system of distributive justice. This chapter begins with an understanding of the concept of inclusive growth and spells out the need for such an approach in India. This is followed by a comprehensive study of the 11th five-year plan brought out by UPA government to delineate the vision of India, the problems faced in achieving it due to disparities and divisions and how government seeks to rectify them through focusing on specific areas which ensures inclusion. The next section assesses the SEZ policy through the yardstick of inclusive growth. Several issues relating to land, labor, financial concessions and environment are scrutinized. It is argued that the SEZ policy does not seem to be in tune with the objective of inclusive growth and concurrently looks at the governmental efforts in correcting the anomalies. This is undertaken to see how a growth strategy can be formulated in a federal polity to reinforce decentralization, harmony of interest and social cohesion.

Inclusive growth: A pre-requisite

The dictionary meaning of term 'inclusive' is 'comprehensive' and 'all-encompassing'. Therefore, inclusive growth must mean a growth that ensures involvement and benefit of all. According to Asian Development Bank, there is no singular definition of the concept of 'inclusive growth'. It varies according to the need and specificities of various countries. However, a broad definition can be formulated as:

'Inclusive growth means growth with equal opportunities. Inclusive growth therefore focuses on both creating opportunities and making the opportunities accessible to all. Growth is inclusive when it allows all members of a society to participate in and contribute to the growth process on an equal basis regardless of their individual circumstances'.⁴

It further states that inclusive growth has both intrinsic as well as instrumental value. It is intrinsic in the sense that all individuals, being the citizens of the country have a right to equal access to opportunities. If they face discrimination while accessing developmental opportunities, it is equivalent to denying rights to the citizens. It has an instrumental

⁴ Ali, Ifzal and Juzhong Zhuang. 2007. *Inclusive Growth Towards Prosperous Asia: Policy Implications*, ERD working paper no. 97, Asian Development Bank, July.

value as it ensures the path to growth by removing obstacles in the form of inequalities. These inequalities can accrue due to 'an individual's circumstances such as religious background, parental education, geographical location and caste [which] are exogenous to and outside the control of the individual, for which he or she should not be held responsible'⁵. It then becomes the responsibility of the government to rectify such inequalities through adoption of policies designed especially to mitigate these inequalities. Further, new types of inequalities may emerge due to free play of market, hence the government needs to curb them.

In addition, the basic idea is that growth strategies are not merely concerned with augmenting higher rates of GDP. It also fundamentally addresses the issues such as balanced regional development, environmental sustainability, overcoming egregious social hierarchies and equitable distribution of benefits. Policies defining growth strategies should be made more comprehensive in their approach by including various sectors, regions, economic and social groups. According to Prime Minister Manmohan Singh,

'We need faster growth because at our level of incomes, there is no doubt that we must expand the production base of the economy if we want to provide broad based improvement in the material condition of living of our population, and if we are to meet effectively the rising aspirations of our youth. But the growth alone is not enough if it does not produce a flow of benefits that is sufficiently widespread. There is a need for growth process that is much more inclusive, a growth process that raises incomes of the poor to bring about a must faster reduction in poverty, a growth process which generates expansion in good quality employment, and which also ensures access to essential services such as health and education for all sections of the community'⁶.

Growth without inclusion could have dire consequences for the nation especially in the present phase of economic liberalization. However, mere adoption of the rhetoric of inclusive growth as a populist measure to gain votes for those excluded, could substantially weaken the state in the longer run. The need for a policy of inclusive growth has emerged mainly due to three reasons in the case of Indian federal polity:

⁵ Ibid, p. 10.

⁶ Singh, Mahmoan. 2007. 'Agriculture, Education, Health and Infrastructure are Priority Areas', *Yojana*, April, p. 4

a) It augments the project of nation building: Indian federation is marked by socio-cultural and linguistic diversities. In addition, economic disparities, as in any other federation, also exists. Hence, one of the major challenges facing the Indian federation is the constant quest of maintaining social cohesion of the nation⁷. Inclusion of all in the decision-making, processes and outcomes addresses this problem. Inclusion therefore has become the guiding principle for policy-makers especially for economic growth. According to Ashoka Mody, 'recognizing the risks- as well as the potential – of India's diversity, technical approaches [of the bureaucracy and state elites] to economic policy-making and more importantly, the political process have made "inclusive growth" their unchanging focal point'⁸. Inclusive growth ensures that the interests of all the different groups are addressed and therefore all are meld together into a nation irrespective of the inbuilt disparities and hierarchies within the society.

b) It ensures stable economic growth: As already mentioned, by taking into account all those who are excluded from the process of growth both in terms of decision-making and distribution of benefits, the growth potential is highly augmented. Inclusion helps in seeking participation as well as cooperation of the masses and in turn smoothens and stabilizes the process of growth.

c) Growing disparities and divides in India: Economic reforms have reconfirmed the necessity of such an approach. According to Francine Frankel, social and regional consequences of the reforms have furthered the creation of two economies⁹. She has several empirical reasons to argue so. First is the difference in economic performance of the states in post reform period. This shows that the inequalities between different states are increasing. It is also seen in terms of Human development index. This situation is exacerbated considering the fact that approximately 18 per cent of population live in high-income states and close of thirty percent in the low-income states. Consequently, 'if the low growth rate persist among such a large percentage of the total population throughout the decade disparities among states will grow wider, poverty will become more regionally concentrated, raising national growth rate above seven percent will

⁷ See, Arora, Balveer. 2001. 'Coalitions, Reforms and the New Federal Polity', *Social Action*, Vol. 51, July- September, p. 295.

⁸ Mody, Ashoka (ed.) .2006. *Inclusive Growth*, New Delhi: Orient Longman, p. 1.

⁹ See, Frankel, Francine, R. 2005. *India's Political Economy 1942-2004: The Gradual Revolution*, New Delhi: Oxford University Press, pp. 580-625.

become problematic and the outcome would be “socially and politically explosive”, affecting the stability of the politics of the country as a whole’¹⁰.

Second, Francine argues that the working population of the India is going to rise to 900,000,000 by 2025. However, at present 26 percent of the population cannot earn enough to take them above the poverty line. In rural areas underemployment and wage instability afflicted groups with the lowest asset base, are also tended to be disproportionately drawn from among the most marginalized members of society, i.e. the Scheduled Caste (SC), the Scheduled Tribes (ST) and the Muslims. Their access to social services is also limited¹¹. Third, an encouraging factor is that poverty has declined from 26 per cent in 1999/2000 compared to 36 percent in 1993/94 with a relatively small differential between rural and urban areas of 27 percent and 23.6 percent respectively¹². However, still a lot of progress has to be made in developing the ‘human capital infrastructure’. In addition, poverty has to be reduced further and more investments need to be made in social service sector if crime and social conflicts have to be kept under control. Lastly, there is a need to boost the agricultural sector not just to increase productivity but also to take care of the 60 percent of population dependent on this sector.

Giving the example of Andhra Pradesh, a state trying to achieve technology led growth, Francine argues, that this growth strategy does not address the issue of structural inequalities. It assumes that both the problems of inequalities and social injustice would automatically be addressed once higher rate of growth is achieved. Consequently, there is an emergence of two economies across India. There is a smaller, yet sizeable affluent economy growing up in larger cities and spreading to self-contained islands of export-oriented, high technology parks¹³. On the contrary, there is a large population of those predominantly dependent on agriculture, of farmers, ST, SC, religious minorities and women belonging to the other economy. Their expectations for a better living are little and have to struggle hard for securing a livelihood.

¹⁰ Frankel, Francine, R. 2005. *India's Political Economy 1942-2004: The Gradual Revolution*, New Delhi: Oxford University Press, p. 605.

¹¹ Ibid, p.606.

¹² Op. cit., Francine Frankel, 2005, p. 607.

¹³ Francine Frankel, 2005, op. cit., p. 625.

Jan Bremen, an anthropologist based on his research in Gujarat has arrived at similar conclusion¹⁴. He argues that it is not that rich are becoming richer and poor are becoming poorer. A definite upward shift has been noticed in the standard of living of the masses and especially the marginalized. However, there is a growing polarity between two sections of the society. At the top are affluent people, who do not reflect any sense of social solidarity since majority migrate to developed countries and there is no sense of responsibility among them for improving the condition of the country. At the bottom are those who are poor, have little access to social services, employed mostly in unorganized sector and have difficulty to earn their living. In addition, the rate at which people at the top are growing is much faster than the rate at which people at the bottom are growing. Hence, according to Bremen there is lack of inclusive growth because of growing disparity.

Amit Bhadhuri, also argues on the same lines when he talks about ‘two Indias’¹⁵. He further adds that ‘the unprecedented high economic growth on which privileged India prides itself is a measure of the high speed at which India of privilege is distancing itself from the India of crushing poverty’¹⁶. This shows that the non-inclusive nature of the economic growth is taking shape. Hence, the need for inclusive growth has become even more pertinent. Realizing this, the 11th five-year plan has made inclusive growth, its primary objective. Below is an assessment of this plan.

Towards faster and more inclusive Growth: The 11th five-year plan

The vision of the 11th Plan is to ensure ‘faster, broad based and inclusive’ growth. The attempt inter alia is to give momentum to ‘National Common Minimum Programme’ by boosting agricultural production, accelerating growth of micro, small and medium enterprises, formulation of effective sector wise policies for allocation of public resources

¹⁴ See, Bremen, Jan. 2007. ‘Of Peasants, Migrants and Paupers; Wage Hunters and Gatherers; The Labouring Poor in India’ New Delhi: Oxford University Press.

¹⁵ See, Bhaduri, Amit. 2007. ‘Development or Developmental Terrorism?’ *Mainstream*, February 23-March 1, pp. 14-16.

¹⁶ Ibid, p. 14.

for employment generation through financing programmes, which will ensure more broad based and inclusive growth. Simultaneously, private investments are encouraged in farming micro, small and medium enterprises, and corporate sectors by formulating more appropriate sector wise policies encompassing healthy competition. However, it is observed that even after incurring substantial expenditure, objectives are often not achieved by the designed programme. One of the major reasons of this is the failure to bridge the existing divides and disparities. Further, they have been aggravated in some cases. These disparities are of various types¹⁷:

- Rich and poor
- Those who have access to essential services such as health, education, drinking water, sanitation etc., and those who do not
- Groups which are excluded from the society such as STs, SCs and some minority and Other Backward Classes which continue to lag behind the rest.
- Gender
- Urban and Rural India
- Disparities between states and within states

The plan therefore proposes a strategy of inclusive growth to curb above mentioned exclusion. The emphasis is given to following areas to achieve the objective of inclusive growth:

- a) Investment requirements: According to the plan to achieve a growth average of 9%, the investment rate has to be increased by 26%. Half of this investment has to come from the private sector, for which the investment climate has to be made attractive. Consequently, it proposes steps to reduce taxes, intensive licensing and system of controls. There is also a need to ensure financial inclusion of all micro, small and medium enterprises within the private sector through innovative forms of financing. To expand public services, there is a need to expand public investment.

¹⁷ “Towards a faster and More Inclusive Growth, An Approach to the 11th Five Year Plan”, Government of India, Commission Yojna Bhavan, New Delhi, 9th December 2006, Website: www.planningcommission.gov.in, date of access: 06/08/07, p. 9.

- b) Policies towards agriculture: The plan states, that if inclusive growth has to be achieved there is a need to double the growth rate of agricultural GDP to 4 percent per annum. This will improve the condition of 60 per cent of the population, which is dependent on the agriculture.
- c) Promoting access to health and education: it is argued that an increase in the income does not ensure access to essential public services such as health, education, nutrition and clean drinking water. For this, therefore the states need to step forward and provide access and availability of services by improving public delivery system and through public action. For appropriate deliverance, accountability and transparency in the functioning of the state governments have to be improved.
- d) Developing infrastructure: The biggest constraint on rapid growth in the years ahead will be the lack of physical infrastructure and its poor quality compared with our competitors in other developing countries¹⁸. This has therefore become a priority for both the state and the Central governments. However, according to the plan the total expenditure required to improve the infrastructure far exceeds the total public funds available. Hence, the alternative approach is through public private partnership. Developing infrastructure is especially important for rural areas for ensuring inclusiveness in the growth process. Only this can ensure proper access to housing, connectivity, water and electricity supply to remote villages.
- e) Special focus on weaker sections: this plan gives a lot of attention to the needs and requirements of the SCs, STs, minorities, women and others marginalized groups. Bringing them at par with those in the rest of the society will not just ensure harmony of interest but will also bolster the process of growth through inclusion of all in the same.

¹⁸ Ibid, p. 102.

- f) Environmental Sustainability: increase in population growth often puts pressure on the environment. Further, the target to achieve rapid growth means an intensification of environmental degradation. Since growth cannot be abandoned, therefore effort to design such policies which are environment friendly needs to be ensured. Further steps to control future pollution also have to be considered. There is a need to improve the water and air quality, manage solid waste, preserve wildlife and bio-diversity, mitigate land degradation through green cover, increase the green cover and demand for the industrial unit to get industrial clearance.

- g) Employment generation: employment is an area, which shows where our growth process is failing on inclusiveness¹⁹. Numbers of workers are increasing especially in non-agricultural areas yet many are unemployed, underemployed and the quality and the character of jobs provided is poor. Further there is a large difference in the wage rates. Therefore, more employment needs to be generated.

The Chart 5.1, on the next page gives the socio-economic targets of the 11th five-year plan. Based on the above-mentioned areas of priority laid down by government of India, it is possible to assess the policy of special economic zones and see how far the policy is able to meet the objective of inclusive growth.

Assessment of the Policy of Special Economic Zones

The Act of special economic zones was passed in the Parliament in May 2005. When the bill was proposed in the Parliament, there were two most important issues on which objections were raised namely the clause relating to flexible labor laws and the centre-state implications of the policy. Implementation of special economic zones policy has also met with a lot of opposition, since then. Scholars, politicians, bureaucrats, social activists and NGOs have all criticized the policy

¹⁹ Ibid, p. 78.

Chart 5.1, Monitorable Socio-Economic Targets of the 11th Plan

Income & Poverty

- Accelerate growth rate of GDP from 8% to 10% and then maintain at 10% in the 12th Plan in order to double per capita income by 2016-17
- Increase agricultural GDP growth rate to 4% per year to ensure a broader spread of benefits
- Create 70 million new work opportunities.
- Reduce educated unemployment to below 5%.
- Raise real wage rate of unskilled workers by 20 percent.
- Reduce the headcount ratio of consumption poverty by 10 percentage points.

Education

- Reduce dropout rates of children from elementary school from 52.2% in 2003-04 to 20% by 2011-12.
- Develop minimum standards of educational attainment in elementary school, and by regular testing monitor effectiveness of education to ensure quality.
- Increase literacy rate for persons of age 7 years or more to 85%.
- Lower gender gap in literacy to 10 percentage points.
- Increase the percentage of each cohort going to higher education from the present 10% to 15% by the end of the 11th Plan.

Health

- Reduce infant mortality rate (IMR) to 28 and maternal mortality ratio (MMR) to 1 per 1000 live births.
- Reduce Total Fertility Rate to 2.1.
- Provide clean drinking water for all by 2009 and ensure that there are no slip-backs by the end of the 11th Plan.
- Reduce malnutrition among children of age group 0-3 to half its present level.
- Reduce anemia among women and girls by 50% by the end of the 11th Plan.

Women and Children

- Raise the sex ratio for age group 0-6 to 935 by 2011-12 and to 950 by 2016-17.
- Ensure that at least 33 percent of the direct and indirect beneficiaries of all government schemes are women and girl children.
- Ensure that all children enjoy a safe childhood, without any compulsion to work.

Infrastructure

- Ensure electricity connection to all villages and BPL households by 2009 and round-the-clock power by the end of the Plan.
- Ensure all-weather road connection to all habitation with population 1000 and above (500 in hilly and tribal areas) by 2009, and ensure coverage of all significant habitation by 2015.
- Connect every village by telephone by November 2007 and provide broadband connectivity to all villages by 2012.
- Provide homestead sites to all by 2012 and step up the pace of house construction for rural poor to cover all the poor by 2016-17.

Environment

- Increase forest and tree cover by 5 percentage points.
- Attain WHO standards of air quality in all major cities by 2011-12.
- Treat all urban waste water by 2011-12 to clean river waters.
- Increase energy efficiency by 20 percentage points by 2016-17.

Source: "Towards a faster and More Inclusive Growth, An Approach to the 11th Five Year Plan", Government of India, Commission Yojna Bhavan, New Delhi, 9th December 2006, Website: www.planningcommission.gov.in, date of access: 06/08/07, p 100.

because of its socio-economic repercussions. There have been instances of mass upheaval in Singur and Nandigram in Bengal and Kalinga Nagar in Orissa. What follows is the assessment of the policy from the inclusive growth perspective on number of accounts:

- Land: Land is a scarce resource. However, there always has been an acute demand for this resource for various purposes such as housing, agricultural and allied services and establishing industrial units. For the same reason, acquisition of land for establishing SEZs has become the most contentious issue in the recent past. Further, people directly concerned or indirectly dependent on the land are generally from economically poor background. Consequently, acquisition of land for SEZs has brought the concern for inclusive growth sharply into focus. A number of problems have surfaced concerning land.

First, there has been a growing concern that prime agricultural land is being acquired for SEZs. If agricultural land is acquired then the worst hit would be those like tenants, landless workers and small peasants belonging to the lowest strata of the society²⁰. This would result in loss of livelihood for these people. Such an acquisition, is according to many taking place despite the stipulation given to various state governments that SEZ can be established only on barren and wasteland. Cases such as that of Singur, Nandigram and Kalinga Nagar brought out instances of mass upheaval against land acquisition. As a result of this, the Commerce Minister on September 25, 2006 announced that “the BOA for SEZs has made it mandatory that no proposals for setting up SEZs on prime agricultural land be cleared²¹. Sonia Gandhi, the Congress President also laid down the following guidelines for the Congress ruled states on September 26, 2006.

²⁰ See, Dogra, Bharat.2007. ‘SEZ: Tinkering Wont Help – the Law Should Be Repealed’, *Mainstream*, June 15-21, pp.5-6.

²¹ As quoted in Dutt, Ruddar. 2006. ‘Special Economic Zones’, *Mainstream*, November 10-16, p.17.

‘Prime agricultural land should be not normally be diverted to non-agricultural uses. Industry requires land. But this must be done without jeopardizing agricultural prospects’²².

In addition, with the insistence of the left government, the Central government has set the limit on acquisition of double crop land to 10%²³. People have also raised questions about the acquisition of the wasteland for the purpose of SEZs. About 19.2% of total geographical area in India is classified under various categories of wasteland²⁴. It is argued that a piece of land is never entirely a waste. What the government or SEZ developer might term as wasteland, may still be of some use for the people in the local area. People of the lowest strata might depend on this land for various purposes like timber, fuel, fodder, non-timber forest products, herbs, bamboo, straw, watershed and grazing grounds²⁵. Further, its importance in terms of maintaining the ecosystem of the area cannot be overlooked.

Second, there is a growing apprehension that establishing SEZs could create food security crises and loss of vital natural resources. India already imports many staple food items like edible oils, wheat and pulses and transfer of agriculture land for SEZs could aggravate the scarcity²⁶. For instance, Reliance is establishing the second largest SEZ in the world in Maharashtra. It covers an area of approximately 35,000 acres that includes 100 villages consisting of 1.5 lakhs families. A Government official admitted that ‘the entire region is the states rice bowl. Almost every family in the villages cultivate paddy though majority of them are small and marginal farmers making land acquiring process more complicated’²⁷. Similarly, Mangal Rai, the Director – General of Indian council of Agricultural Research on the question of food security, issued precaution. He said:

²² Ibid.

²³ See, Choudhary, Subhanil. 2007. ‘*Industrialization in West Bengal: Addressing the Real Issues*’, published by Progressive Printers, New Delhi.

²⁴ Sharma, Sheetal & Kishan Pratap. 2007. ‘The Prosperous Few and the Pauperized Many: A perspective on Special Economic Zones’, *Mainstream*, March 23 – 1 April p. 19.

²⁵ Asher, Manshi. 2006. ‘Don’t Call it Waste Land’, *Times of India*, October 12.

²⁶ See, See, Dogra, Bharat. 2007. ‘SEZ: Tinkering Wont Help – the Law Should Be Repealed’, *Mainstream*, June 15-21, pp.5-6.

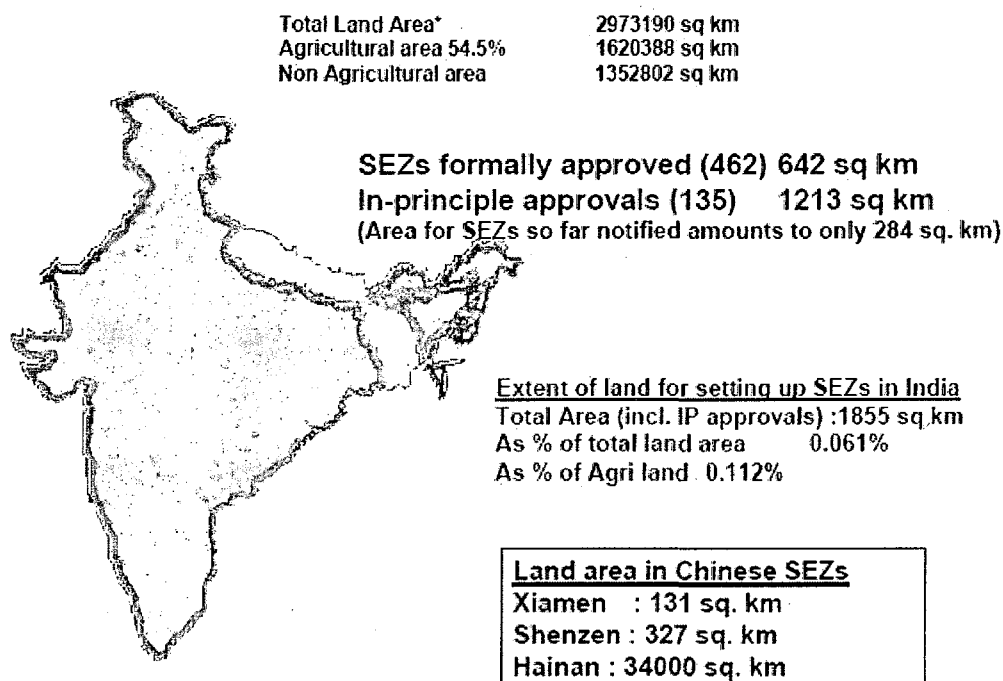
²⁷ Report in *Economic Times*, October 2, 2006.

‘Since land area is limited and agricultural land is the most precious, one must be very careful. One will have to take into cognizance the long-term effects of the food security of this country. Food security is an integral part of national security’²⁸.

However, this concern seems to be a little exaggerated if the official figures are considered regarding the use of prime agricultural land in establishing SEZs. Chart 5.1, shows that the only 0.112% of the total agriculture land has been acquired for setting of SEZs.

Chart 5.1, Agricultural Land Acquired for SEZs

Land Requirement for SEZ in India -Ground realities



*Source: Ministry of Agriculture, GOI

Third, acquisition of land became such a contentious issue because of the involvement of state governments. It was argued that the state governments were acquiring land on behalf of private investors in the name of public purpose. Section 4 of the SEZ act, and the land acquisition act of 1894 allows the state

²⁸ As quoted in Dutt, Ruddar. 2006. ‘Special Economic Zones’, *Mainstream*, November 10-16, p. 19.

governments to acquire land. The basic issue of dispute then was that a nexus between the state governments and the private investors. Many argue that acquisition of land by the private investors with the aid of state governments would result in concentration of economic power in the hands of few rich individuals²⁹. To lessen concentration of economic power, a demand made to impose a ceiling on the land acquired for SEZs³⁰.

Fourth, concerns are raised about the land use within the SEZs. Section 5(2) of the Act allows about 75% of land within SEZs for non-industrial use. This means that the main purpose of SEZs to produce goods for export can get defeated. Since 75% of land acquired can be used for activities like building hotels, housing and various other non manufacturing purposes. Further, no taxes will accrue to such real estate activities. Leaders of various political parties like CPI(M), Jan Morcha and RJD argued that this is an open license for real estate racketeering³¹. The problem further complicates as large numbers of SEZs are mainly multi-products, which are permitted to acquire huge chunks of land³². The chances of mis-utilization of land in such SEZs are highest. The state governments are facing a problem in implementing the SEZ act, as there is no clear-cut central government policy to prevent improper use of land³³. CPI (M) demanded that at least 50% of the total land should be used for processing area, and at least 25% should be dedicated for building of infrastructure³⁴. Another related problem is the rise in real estate prices. Once the land is acquired the prices in an around suddenly faces an inflation. For instance, the average land price at Jhajjar, Haryana is set to have risen from four lakhs per acre to 40 lakhs because of the

²⁹ See, Mukhopadhyay, Partha. 2008. 'The Pomissied Land of SEZs', *Seminar*, Vol. 581, pp 28-35.

³⁰ See, Choudhary, Subhanil. 2007. '*Industrialization in West Bengal: Addressing the Real Issues*', published by Progressive Printers, New Delhi.

³¹ Ramakrishnan, Venkitesh. 2006. 'Conflict zones', *Frontline*, Volume 23 - Issue 20, October 7-20.

³² After IT/ITES/Electronic Hardware/Semiconductor and bio tech parks, multi product SEZs are largest in number in the list of approved SEZs. Source: http://www.sezindia.nic.in/HTMLS/Sector-wise_distribution_of_SEZs.pdf, date of access 25/04/2008.

³³ See, Ramakrishnan, Venkitesh. 2006. 'Conflict zones', *Frontline*, Volume 23 - Issue 20, October 7-20.

³⁴ See, Choudhary, Subhanil. 2007. '*Industrialization in West Bengal: Addressing the Real Issues*', published by Progressive Printers, New Delhi.

proposed SEZs in the area³⁵. Hence, the general cost of living increases. Such an increase may not be conducive for the health of the economy as the returns from other productive activities like agriculture and industries are much lower.

Fifth, and the biggest issue is that of displacement. According to Praful Bidwai, even if conservative assumptions are taken the SEZs notified areas would not consist of a population density of less than 5000. Based on this if an estimate of the number of people displaced by SEZs is calculated, it works out to be 1.14 million³⁶. As already mentioned the SEZs are coming up in areas, which have good infrastructural facilities, and hence have more population residing in those areas, magnifying the problem. The issue of displacement goes beyond the loss of livelihood of people, which with existing skills find it difficult to get source of subsistence. It seeks to threaten the cultural and social heritage of the displaced. There is a loss of vibrant local economy in and around SEZs proposed area. Besides, compensation given to the displaced is not adequate and according to the market value.

These are the most important criticism of the SEZ policy relating to the land issues. The SEZ policy that does not address these issues and the growing discontentment among people forced the government to rectify the loopholes. The government through various meetings, consultations and discussions, made major changes in the policy. It came out with a policy of resettlement and rehabilitation, amended the Land Acquisition Act (LAA) 1894, and took the guidelines given by various Egom (Empowered Group of Ministers) meetings and the left parties. Below is a discussion of each of these to see how government has attempted to work out a policy of inclusive growth. At the same time, it is pointed out that a lot still needs to be done.

³⁵ Kumari, Pushpa. 2006. 'SEZs-First Best or Second Best?', *Mainstream*, September 8-14, p. 27.

³⁶ Bidwai, Praful. 2008. 'Zones for Scan – Beyond the Obvious', *Frontline*, February 29, p.111.

Through various meetings held by Empowered Group of Ministries (Egom), several important decisions relating to the land issues have been taken³⁷. They are as follows: -

The first decision was to prohibit the state governments to acquire land on the behalf of private players. Even in case of joint ventures with private parties the state governments cannot acquire land. It is solely the responsibility of private players to acquire land. This is a very important decision as conditionality attached when the government acquires land is not present. For instance, the state governments on the conditions that SEZs are a part of public utility services can no longer acquire land for private players at less than market price. State governments can acquire lands for setting up SEZs only if it ensures proper relief and rehabilitation of the displaced. In a broader sense, it will also aid the government to maintain its legitimacy. However, the withdrawal of the state governments from acquiring land can lead to rise in illegal activities of land mafia.

The second relates to restructuring the land use pattern within SEZs. The upper limit of the area required for multi product SEZs has been fixed at 5000 hectares, which might be further lowered by the State Governments. It has been stipulated that the minimum processing area within a multi product and sector specific SEZ have to be 50%, from the earlier requirement of 35% of total allocated area. This is a very important decision because it will ensure sufficient manufacturing of goods meant for export. This decision not only justifies the creation of SEZs but also protects from real estates racketeering. It has fixed the size of land that can be acquired, especially for multi product SEZs, and have ensured proper utilization of land, a vital resource. In the same line, the government has also

³⁷ See, 'Freeze On Sezs Lifted, With Tighter Rules – Ceiling On Size Of Sezs Fixed At 5000 Hectares – Kamal Nath Outlines Decisions Taken At Egom', Press Information Bureau, Government of India, Website: <http://pib.nic.in>, date of access:28.04.08. Also see, 'Empowered Gom Resolves Sez Issues – Significant Inflow Of Investment In Zones Expected, Says Kamal Nath', Press Information Bureau, Government of India, Website: <http://pib.nic.in>, date of access:28/04/08.

made stringent export requirements that ensure that the export targets are achieved.

Lastly, Egom has asked the government to amend LAA 1894 and put in a proper policy of resettling and rehabilitation to mitigate the woos of the displaced. Again, it is a very important step to abate the costs involved in the process of development. This issue will be discussed in detail later.

The Government of India has also rectified the SEZ policy keeping in view the suggestions made by the left parties³⁸. However, the Central Government has still not accepted certain recommendations. The need to do the same is exigent, since these recommendations can help in framing a more comprehensive and just policy. A discussion of these will show how a more compatible policy of SEZ can be formulated.

Left parties are demanding that there should be no transfer of land ownership to the private investors, rather the land should be leased for a certain period. Those displaced should be made stakeholders in the SEZ units and ensure some means of earning for the displaced people. There should be a ceiling on the land acquired by the private investors and that big SEZs should be build only by state governments. In addition, government should attempt to establish SEZs in those states where no proposals from the private developers have come. These are very significant demands, as it will prevent the concentration of economic power in the hands of few. Like Egom the left has also demanded framing of R & R policy, to give guidelines for land use within SEZs and criteria for processing / non-processing areas.

The most critical step towards inclusive growth, taken by government of India was the formulation of R & R policy and the amendment of LAA 1894. The section below examines both the acts, looks at how it provides relief and mentions certain areas where both innovation and improvements have to be brought in.

³⁸ See, Choudhary, Subhanil. 2007. *Industrialization in West Bengal: Addressing the Real Issues*, New Delhi : Progressive Printers.

The government of India did not have a resettlement, relief and rehabilitation policy for a long time. According to Ramaswamy Iyer, the thinking for formulating such a policy began as late as in 1980s to govern the future of those which were displaced by all developmental projects like roads, highways, dams, mining and industrial projects³⁹. Since then, it has taken more than 20 years to formulate R&R policy.

In the mean period, 'issues relating to Resettlement and Rehabilitation [were] addressed by several State Governments and various policies in the water and energy sector'⁴⁰. The Central government did not have any concrete policy to look into the plight of the displaced or assist the impact of such projects on society and environment. It did not enter into any activity of planning beyond the developmental project, nor did it seek the participation of project-affected people in the decision-making. Land was acquired based on LAA 1894 by declaring any area for public purpose. Decision taken based on this declaration cannot be challenged in the court because it is done in the name of public interest.

This Act talks about compensation but it cannot be negotiated and is not based on the market prices. Moreover, it talks about compensation only in monetary terms. It fails to consider other forms of compensation in the form of jobs and land for land. In addition, it does take into account those displaced who are not directly dependent on the land. For instance, fishermen, shopkeepers, tea shop owners, potters, herdsmen and carpenters. No compensation has been offered to them. Another category of displaced people the Act ignores, are those who do not hold land privately due to incomplete documentation or community acceptance. Lastly, the act only deals with land rights. It does not talk about people dependent on water, forest and other resources in and around the land. Other problematic clauses of this act are:

³⁹Iyer, Ramaswamy.2007. 'Towards a Just Displacement and Rehabilitation Policy', *Economic & Political Weekly*, July 28. pp.3103-3107.

⁴⁰ See, 'Perspectives On The R&R Policy', National Advisory Council, Website: www.nac.nic.in , date of access: 19/07/07.

a) The definition of 'public purpose' on which the state acquires the land is not open to contestation. Many argue that public purpose only means developmental projects like building dam, highways and that the government has misused the law for acquiring land for SEZs. b) The act does not talk about issuing notifications to people whose lands are being acquired. c) Many ridiculed that LAA designed by Britishers in 1894 to exploit the Indians is still in operation. No modifications were made in the Act since then irrespective of the changes that have taken place in the Indian polity.

In short, this act treats individuals as 'instruments' in the process of development rather than considering them as end in themselves. It is no surprise then, that the acquisition of land made under this Act for SEZ came to be so widely opposed. Government is attempting to amend this Act. At present it has only changed the clause relating to public purpose. According to it, land acquired under public utility cannot be transferred for any other purpose besides public utility. If the land remains unutilized for more than 5 years, than the land could be returned to the government concerned. However, government has still not redefined the meaning of public purpose. According to Iyer, three major amendments need to be made: a) while acquiring land through this act, it should be made contestable in court, b) The act needs to be made more humane and equitable c) terms of compensation should be made just⁴¹.

In this backdrop, the formulation of R & R policy, 2007 has been a path-breaking legislation. The new policy and the associated legislative measures aims at striking a balance between a need for land for developmental activities and, at the same time, protecting the interest of land owners, and others, such as the tenants, the landless, the agricultural and non agricultural laborers, artisans and others whose livelihood depends on the land involved⁴². The objective therefore

⁴¹ Iyer, Ramaswamy.2007. 'Towards a Just Displacement and Rehabilitation Policy', *Economic & Political Weekly*, July 28, p. 3106.

⁴² 2007. 'Rehabilitation and Resettlement Policy and Associated Legislative Measures Relating to Land Acquisition', Press Information Bureau, Government of India, October 11, Website: <http://pib.nic.in/release/release.asp?relid=31832>, date of access: 27/04/08.

mentioned in the policy is to as far as possible minimize displacement and look for alternatives. If displacement is inevitable then just and adequate rehabilitation package should be given. Speedy implementation with involvement of those affected also needs to be ensured. It also emphasizes on taking special care of people from the weaker section of the society and seeks to gain approval of affected persons and the third tier, especially in the case of tribals.

The larger aim of the government is to see that with rehabilitation the displaced are able to sustain the same standard of living, if not better. However, the policy does not talk about any concrete measure to ensure minimum displacement. Section 2.1(e) states '*to integrate rehabilitation concerns into the development planning and implementation process*'⁴³. This statement seems to contradict the governmental stand to ensure minimum or no displacement; because it assumes that with development, there will be displacement.

The next section of the policy comprehensively defines the category of displaced. It includes not only those who are affected by displacement directly but also mentions about those who have been affected indirectly. It makes space for not just agricultural laborers but also rural artisans, small traders and self-employed people. The policy mentions about compensation in various forms like land for land, employment to at least one person in the affected families, training for self-employment, scholarships, and establishing groups of co-operatives. It also mentions about giving financial support for cattle sheds, shops; transportation costs, health care, drinking water, sanitation and religious activities.

Monitory transactions, according to the act, would be according to consumer price index. Most important thing is that the policy has made special provisions for vulnerable persons, such as the disabled, destitute, orphans, widows, unmarried girls, abandoned women, or persons above 50 years of age, for instance giving them lifetime pension. Individuals can also opt to take up to 20% of the

⁴³ See, *National Rehabilitation and Resettlement Policy 2007*, Government of India, Ministry of Rural Development, published in the Gazette of India, Extraordinary, Part 1, Section 1, dated 31st October, 2007.

rehabilitation grants in the form of shares in the company establishing SEZ. Considering the above-mentioned compensation package, the policy seems to be not just comprehensive but also progressive. However, the past record of the government, especially in the case of Narmada Dam much has not been very impressive. Therefore, much depends upon the political will and the effective implementation of policy. According to the left parties, R & R policy should also mention a model of compensation and rehabilitation criteria in the SEZ rules.

Creation of strong grievance redressal mechanism along with standing R & R committees at the district and the project level has been prescribed by the policy. These committees will have representatives from affected families, specially women, NGOs, and Panchayats. Appointment of Ombudsman as well as administrator and commissioner for rehabilitation and resettlement has also been mentioned. The policy is just because it mentions about national monitoring committee, cell and oversight committee for looking into the progress of the implementation of the plan. Monitoring would also be done post implementation of R & R scheme. In addition to all of this, the government, in order to ensure transparency, has made it mandatory to give out information regarding any measures within the rehabilitation policy and those affected.

The policy provides provision for assessment of social as well as environmental impact and to evaluate if the developmental project is a feasible option or not. While assessing the impact it will consider issues such as public and community, properties assets, infrastructure, environment and how the concerned body aims to ameliorate the impact. The assessment would be done by experts, representative from the third tier and affected community. Once the report is prepared it is made mandatory for the concerned developer to gain clearance from the government. The policy does not make it obligatory to seek approval from the people before giving clearance to the project.

In all the R & R policy seems to be very comprehensive, progressive and a just policy. It has succeeded in imparting a more inclusive disposition to the policy of SEZs. This policy though needs to address following issues. First, it does not make obligatory for the government to justify the displacement. Second, the policy lacks the power to enforce the politicians, bureaucrats and the policy makers to ensure efficient implementation and hence it is like a tiger without nails and teeth. Lastly, No matter how good a policy is, it becomes diluted at the time of implementation. According to Rob Jenkins ‘even when India’s courts have mandated that government authorities to take specific actions to compensate people affected by large projects – the Narmada Dam is a classic case – implementation has been appalling’⁴⁴. This has been the singularly the most important reason for people fighting to retain possession of their land. Therefore, there is a need to ensure its proper implementation.

- Labor Laws: The second most contentious issue while formulating and implementing the SEZ policy has been that of flexible labor laws. This issue was highly debated in the legislature while passing the bill. The left parties were not ready to accept the clause of flexible labor laws. The basic point of disputation is that rigid labor laws cannot be applied in these zones, as they will cease to appear as viable investment zones. However flexible labor laws go against the article 38(1) of the constitution, which states: ‘The states shall strive to promote the welfare of the people by securing and protecting as efficiently as it may a social order in which justice, social, economic and political, shall inform all the institution of national life’.

In the case of SEZs, the government is constrained to ensure the same because of the need to maintain international competitiveness in the market. A member of CPI (M) central committee Benoy Konar, while arguing that Bengal alone cannot refuse to abolish labor laws, reflects this helplessness of the government. He said

⁴⁴ Jenkins, Rob. 2007. ‘The Politics of SEZs in India: Promise and Pitfalls’, Newsletter published by Center for the Advanced Study of India University of Pennsylvania, Website: http://casi.ssc.upenn.edu/india/iit_Jenkins.html, date of access: 01/04/2008.

that the 'States like Maharashtra, Gujarat, Karnataka and Tamil Nadu announce that they will abolish laws as desired by the center and if the working class there fails to resist such a move, what will our state government do? If we insist on maintaining labor laws in our SEZs, there will be no industries here'⁴⁵.

Therefore, the state governments have adopted flexible laws relating to labor, which are diluted versions of the original laws applicable throughout the country. Flexible labor laws means a number of securities would be taken away from the workers and they might be subjected to exploitation. Sunanda Sen and Byasdeb Dasgupta mentioned different components which determine labor security in India that would be absent in SEZs⁴⁶. The first is employment security. This means that the workers are employed based on a contract, for a fixed period; in the absence of a contract, like in the case of SEZ, workers might be subjected to hire and fire strategy. Second is the income security. Offshore units are known to be established by foreign companies to take the advantage of cheap work force available. Unlike the Western countries because of the abundance of labor, the MNCs pay much lower income to the workers employed. Sometimes these wages are not even according to the local costs of living. Further, they take advantage of the hierarchies build within the social system of the country to their advantage. For instance, women are paid much lower than men are. Bonus, medical benefits, various facilities on the job and other such perquisites are never provided.

The third is the workplace security, which is insurance against accidents, payments against illness, and protection of women during night shifts is not given. Fourth, the government has declared SEZs as areas meant for providing public utility service under the LAA 1894. This means that the labors do not have the security to collectively bargain, strike or represent labor grievances. Lastly, there is no social security net for the workers. No provisions of pension and maternity

⁴⁵ As quoted in Dutt, Ruddar. 2006. 'Special Economic Zones', *Mainstream*, November 10-16, p.18.

⁴⁶ Sen, Sunanda and Dasgupta, Byasdeb. 2007. SEZ: Modern Enclaves to Reward Capital by Exploiting Labor and Displacing Livelihoods in Agrarian Economy', *Mainstream*, April 27-3, pp. 5-9.

benefits are provided. All these factors could make the labor-force vulnerable to exploitation.

There was a lot of pressure from the left parties that considered such flexibility unacceptable. For the government employment generation is an important pillar of the strategy for inclusive growth. Consequently, it not just aims at inviting corporate world to facilitate employment creating in the industry but also aim at more humane and just society by a public private partnership. The union minister of state for labor and employment Oscar Fernandes said: 'we are committed as a government to work with industry for transformation of our economic and social landscape. We do not believe in adversal relationship with industry but in a genuine partnership'⁴⁷. Consequently, owing both to the pressure of the left parties and the policy programme of Congress SEZ Act were amended. According to the amendment section 49 of the Act that gives the right to the Central government to repeal or modify the laws within SEZs, would not be applicable in the case of labor laws. More specifically the Centre cannot remove or modify laws 'relating to trade unions, industrial and labor disputes, welfare of labor including conditions of work, provident funds, employers liability, workmen's compensation, invalidity and old age pensions and maternity benefits applicable in any Special Economic Zones'⁴⁸.

However, this amendment holds little validity. Labor is a subject of concurrent list. This implies that the work force is protected by 23 Central Government legislations and at least seven to ten acts of the respective states. In the process of making the zones more competitive, the state governments have differently formulated the labor laws for SEZs. For instance, Andhra Pradesh and Maharashtra have more favorable labor laws for investors because they have

⁴⁷ Presidential Address by Oscar Fernandes on Occasion of 42nd Session of Standing Labor Committee, New Delhi: December 13, 2007.

⁴⁸ See, 'Chapter VIII: Miscellaneous', Section 49 (b) in *The Special Economic Zones Act 2005*, Published in The Gazette of India, Extraordinary Part II – Section I, Published by Authority (no.31), New Delhi, Thursday, June 23, 2005, Ministry of Law and Justice (legislative Department), 23rd June, 2005/ Asadha 2, 1927 (saka), p. 33.

amended contract Act and industrial dispute Act. On the contrary, West Bengal is far behind in this race of providing concessions because of its ideological anchoring⁴⁹.

The next issue relates to management of workers within the SEZ. The SEZ notification, 2006 expects the state governments to transfer the power of the Labor Commissioner to the Development Commissioner of SEZs⁵⁰. Traditionally the state's Labor Commissioner conciliated the disputes arising between labor and managements. However, with the SEZ notification, the states are to delegate this power to the MOCI representative i.e. the development commissioner. The role of the development commissioner is like an entrepreneur whose main aim is to woo investors. However, to delegate the power to resolve disputes between workers and their managements to the DC cannot ensure fair judgment⁵¹.

Government of India has yet to formulate a comprehensive policy for labor organization within SEZs. Even China's record of accomplishment on this account has not been very satisfactory. Since labor is the most vital component in attracting investment and that there are more than 3000 trade zones in the world, government's reason for hesitation in framing more protective labor laws is evident. However, one aspect that the critics of the SEZ policy fail to notice is the labor conditions already in existence in the unorganized sector. According to Ministry of labor, only 26.46% of jobs were available in the organized manufacturing and service sector in 2005⁵². The rest of the labor force is

⁴⁹ See, Dutt, Ruddar. 2006. 'Special Economic Zones', *Mainstream*, November 10-16, pp.18 and Mukherji, Rahul & Aparna Shivpuri Singh. 2006. "Investing in the Indian Special Economic Zones: A Background Paper" at the Institute of South Asian Studies, National University of Singapore, 30 May, Website: www.isas.nus.edu.org, date of access: October 23, 2006.

⁵⁰ See, 'Chapter 2: Procedure for Establishment of Special Economic Zone', Section 5(f), in *Notification of Rules for SEZs, 2006*, Government of India, Ministry of Commerce and Industry (Department Of Commerce), Notification, New Delhi, 10th February, 2006, published in Part II, Section 3 Sub-Section (i) of The Gazette of India, Extraordinary, dated: 10th February, 2006.

⁵¹ See, Sridhar, V.V. 2006. 'Subversive enclaves', *Frontline*, October 20, pp. 19-21. Also see, Mukherji, Rahul & Aparna Shivpuri Singh. 2006. "Investing in the Indian Special Economic Zones: A Background Paper" at the Institute of South Asian Studies, National University of Singapore, 30 May, Website: www.isas.nus.edu.org, date of access: 23/10/2006.

⁵² 'Declining Employment In Organized Sector'. 2008. Press Information Bureau, Government of India, March 19, Website: http://pib.nic.in/release/rel_print_page1.asp?relid=36710, date of access: 25/04/08.

employed in unorganized sector where no or few labor laws prevail. The conditions faced by these individuals are not different from that feared for the workers in the SEZs. Therefore, we need to differentiate whether we are criticizing the absence or flexibility of labor laws throughout the country or only those labor laws, which specifically pertain to SEZs.

This is not to justify the government's approach to labor policy within SEZs. After all the SEZs are in a sense contributing to the growth of unorganized sector. At present, the government has only accepted the recommendation of the left parties regarding the removal of the labor laws flexibility clause. However, the state governments, barring few have not shown any initiative to improve the plight of the workers in SEZ. Much needs to be done on this account by both the Centre as well as the state governments, to give the policy a more inclusive character.

- Environmental sustainability: Any developmental project has an impact on the environment. This is especially true for projects that undertake large-scale industrialization. SEZs as zones, which seeks to not only maximize exports but also develop an area into an industrial township has also raised concerns about impact on environment. In general, the environmentalists argue that it will lead to pollution and congestion. This will further disturb the delicate balance maintained in ecosystem. It will also put strain on scarce and depleting resources. This is true for all developmental projects. However, there are several concerns emerging, which are specific to SEZs. They are as follows: -

The first is about the location of SEZs. As already stated, most of the SEZs are being established in infrastructurally rich areas. This means that greater pollution and depletion of resources will take place due to SEZs that have a tendency of creating a lot of pollution. SEZs usually come up in areas, which are well connected. Hence, construction near coastal areas that provide port facilities is seen. Such coastal areas are generally rich in terms of bio diversity. SEZs have

the potential to hurt both flora and fauna of these areas like in the case Mundra SEZ in Gujarat⁵³.

The Gujarat state government has given approval for industrial establishment along the coastline that can potentially damage the environment. Areas around Mundra SEZ are known for its mangrove vegetation. This vegetation is very important to not only maintaining the ecosystem but also because it provides home to several endangered species like whale shark, sea cow, dolphins and turtles⁵⁴. According to forest survey of India, mangrove cover is depleting due to the developmental activities taking place in the area⁵⁵. According to their study, Mundra SEZ that covers 13,000 hectares of land has about 3,000 hectares of mangrove vegetation.

Second, as already pointed out in the fourth chapter, haphazard development of SEZs is taking place. Issues such as migration, strain on already existing resources and infrastructure and creation of additional infrastructure are not taken into consideration. This can adversely affect the environment. Owing to unplanned growth, issues like waste disposal, afforestation to reduce pollution and acquisition of resources are not worked out.

Due to these factors, government has made it mandatory for all the projects to get an Environmental Impact Assessment (EIA) clearance before establishing SEZ unit. Section 17 (2) iii, of the SEZ notification, 2006 states, 'The Approval Committee shall approve the proposal if it fulfills the following requirements (...) the applicant undertakes to fulfill the environmental and pollution control norms,

⁵³ See, Janyala, Sreeniva. 2007. 'SEZ: Gujarat Department Alarmed at Forest Loss', *Indian Express*, March 27. Also see, Pandya, Mahesh. 'SEZ in Gujarat – Mundra SEZ- A Case Study', Website: <http://whysez.com/PDF%20Files/Reports/Mundra%20SEZ%20-%20Mahesh%20Pandya.pdf> , date of access: 28/04/08.

⁵⁴ See, Janyala, Sreeniva. 2007. 'SEZ: Gujarat Department Alarmed at Forest Loss', *Indian Express*, March 27.

⁵⁵ Ibid.

as may be applicable'⁵⁶. Even the R & R policy of 2007, chapter 2, section 6 (1) makes a provision for an environmental impact assessment, by the ministry of environment and forest⁵⁷. It also states during such an assessment participation of the local population has to be ensured.

Since experts make the assessment from Ministry of environment and forest under the central government; there is a lack of participation of the state governments in the entire process. Gaining such a clearance is very crucial for maintaining the long-term health and environment of the Nation. A need to maintain transparency in this process is also very vital. For instance, SEZ in Mundra Gujarat as already mentioned has gained approval for establishing the units. However, the state, Centre or the Ministry of environment and forest make no mention about the EIA and its status, on their website.

- Miscellaneous: This section reiterates certain concerns already mentioned in the earlier chapters. A discussion of these issues is important to understand their socioeconomic implications and what it holds for distributive justice within the society. The first issue is regarding the regional imbalances, which might accrue due to special economic zones. A speaker of Rajya Sabha said that 'we have always stated that our developmental process has to be all inclusive. Not only all-inclusive but must encompass all states'⁵⁸. In the case of China, it has been seen that the development was highly uneven that is taking place only in certain pockets. There was no trickle down effect to other regions or to the lowest strata of society⁵⁹.

⁵⁶ See, 'Chapter 2: Procedure for Establishment of Special Economic Zone', in *Notification of Rules for SEZs, 2006*, Government of India, Ministry of Commerce and Industry (Department Of Commerce), Notification, New Delhi, 10th February, 2006, published in Part II, Section 3 Sub-Section (i) of The Gazette of India, Extraordinary, dated: 10th February, 2006, p. 13.

⁵⁷ See, *National Rehabilitation and Resettlement Policy 2007*, Government of India, Ministry of Rural Development, published in the Gazette of India, Extraordinary, Part 1, Section 1, dated 31st October, 2007.

⁵⁸ Ibid.

⁵⁹ See: Mukhopadhyay, Partha. 2008. 'The Promised Land of SEZs', *Seminar* Vol.581, p.29.

The concern about inclusion of all is extremely important. As already mentioned, scholars as well as the government is increasingly becoming aware of a growing divide in India. One section of India, which is affluent and enjoys a high standard of living and the other section comprises of those who are poor and find it hard to earn their livelihood. It was believed through employment generation by SEZs the government would be able to mitigate the problem and target poverty. However, going by the data available on the website of ministry of commerce it has become evident that SEZs are creating further regional imbalances, both between as well as within states. This is not necessarily bad as a system of incentives is maintained. Further, benefits also accrue from the regions where SEZs are established in the form of backward and forward linkages. However, there is a lacuna in terms of governmental activity. According to the 11th five-year plan, the government aims to give incentive to the private sector for achieving higher rate of growth and pledges to step in those areas, which are lagging behind. In the case of SEZs however, there seems to be a lack of government's initiative in terms of policies to ensure that the SEZs reach and benefits accrue to areas left out in the process of growth.

This brings us to another important issue of distribution of benefits. On one hand the government is foregoing a revenue of Rs.1,00,000 lakhs crores till the year 2010. Establishment of SEZs has created an extra burden for the government because of the costly affair to rehabilitate the displaced. In addition, there is a loss of the local economy and means of livelihood of the section mainly depending on agriculture and allied activities. On the other hand, the nature of the SEZ policy is such that it gives a lot of incentives as well as concessions to the private investors. This is advantageous because private sector has proved to be more effective in terms of efficiency, productivity and achieving higher rate of growth. However, the benefit from the private sector does not permeate inclusively into the society. Government through the policy of R & R 2007 has taken innovative step of allowing the displaced to become stake holders in the SEZs established. Like this, there is a need for more novel ideas to ensure that the

profits earned through special economic zones accrue to all especially, those who have been historically deprived of benefits.

To conclude, the policy of SEZs needs to be further modified to suit the temperament and need of the Indian society. Government has taken steps to make the policy of SEZs compatible with the concept of inclusive growth. However, it is not sufficient and there are still parts of the policy, which negate the principle of distributive justice. The policy does not appear to empower those who are excluded in the process of development and in this sense does not socio-economically decentralize the polity. This is not because the policy SEZ is bad, rather, it reflects that there is a lot of scope to impart the policy a more decent character and implement it effectively. In this context, the model proposed by the left parties seems to be a righteous model to emulate. It allows both - faster growth to take roots and at the same time ensure harmony of interest. This model could be the way of formulating the SEZ as an inclusive growth policy in a federal polity. The table 5.2, reiterates the main proposals made by the left parties in formulating a more harmonious policy of SEZ.

5.1, Left Parties' Demands for Amendments in the SEZ Act

Issues:	Left Parties Demand
Land Acquisition and Displacement	<ul style="list-style-type: none"> a) No transfer of ownership to private developer b) Appropriate ceiling on total land under a SEZ developer by private developer and bigger SEZs to be built by the Public sector. c) Limiting acquisition of agricultural land. d) Framing National Rehabilitation Policy, amending LAA e) Including model of compensation and rehabilitation criteria in the SEZ Rules f) Recycling land blocked in closed units
Cap on the Number of SEZs	<ul style="list-style-type: none"> a) Apply separate caps on different categories of SEZs b) Government should consider setting up of SEZs in States receiving no SEZ proposal from private developers.
Criteria for Processing/Non-processing Area	<ul style="list-style-type: none"> a) Processing Area should not be less than 50%. 25% should be dedicated for infrastructure development.
Land use within SEZ Area	<ul style="list-style-type: none"> a) Lay down guidelines for real estate development with SEZs. b) Clearly define the role of the SEZ Authority and DC, in regulating real estate development. c) Residential facilities for workers should be provided within SEZ Area.
Review of Tax Concession	<ul style="list-style-type: none"> a) Reduce income tax holiday from 10 years to 2

	<p>years.</p> <p>b) Tax incentives for developers have to be considerably lesser than those enjoyed by entrepreneurs.</p> <p>c) Withdraw fiscal incentives unrelated to exports, like services tax exemption for the developers or STT exemption for non- residents operating through the International Financial Services Centre.</p> <p>d) Concessions to be granted by state governments should not be imposed through the SEZ rules</p> <p>e) Duty concessions on goods sold to the DTA should not be permitted.</p>
Workers' Right	<p>a) Amend those Rules, which enable the state governments to delegate its powers under Industrial Disputes Act to DC and to declare SEZs as Public Utility Service.</p>
Prevent Speculative Finance	<p>a) No need to provide tax incentives for financial entities within SEZs</p> <p>b) All financial activities should be under the regulatory ambit of RBI. RBI should ensure that financial activities permitted within the SEZs are related to the economic activities of the zones</p>

Source: Choudhary, Subhanil. 2007. *'Industrialization in West Bengal: Addressing the Real Issues'*, published by Progressive Printers, New Delhi.

Chapter-6

Conclusion

This concluding chapter first summarizes the main argument made in the first five chapters. It then attempts to put together all the arguments to answer the central concern of the dissertation, which is to see the impact of liberalization on decentralization.

The first chapter outlines the central objective of the study that is, to look at the interaction between federalism and liberalization in India. It seeks to explore whether liberalization has led to dismantling of the centralized structure. It is proposed that to have a substantive analysis of this question it is important to examine federalism, both in legal-politico terms and as a mode of co-existence in a diverse polity. Liberalization is not solely responsible for engendering decentralization. Other factors such as fragmentation and federalization of party system, changing terms of trade between agriculture and industry, apprehension for maintaining unity and integrity of the nation and the concept of welfare state and the development strategy adopted, fundamentally contributed to the same. Through these factors, 50 years of history has been traced to delineate the shift from centralization to decentralization in Indian polity.

In this background, the impact of liberalization on decentralization within the Indian federation is assessed. The balance of payment crises of 1991 impelled India to borrow money from IMF. However, this transfer was not devoid of conditionalities. The conditions put forth were that India had to undertake structural reforms and impose fiscal disciplinary measures. This resulted in restricted transfer of funds from the centre to the states. In this context, it is argued that the process of decentralization at legal politico level was further bolstered as the onus of development was passed on to the hands of States.

However, now for states to develop themselves they needed to attract private investment, urgently. This meant that the states had to adhere to the principal of market. They had to endorse themselves as viable investment regions. Hence, they had to behave like any

other companies in the market by advertising, selling, and making deals with the investors. Liberalization thus evoked the very agency of the states. Hence, on one hand, there was dismantling of a strong center and on the other hand, the states gained the autonomy to govern themselves.

To attract funds from the markets, the states have to compete with one another. In this competition, the states would have to appear as viable investment zones based on good infrastructural facilities, skilled labor and good governance. Since most of the states lacked on this account, they had to adopt the other alternative of providing concessions. It is argued, that providing concessions had a negative impact on the masses. However, in such a situation the states do not have any other alternative growth strategy. This centrally brings in focus the idea of federalism as a system of co-existence, which is meant, to ensuring harmony of interest, liberty to different groups and at the same time maintains social cohesion.

It is argued, that it is not sufficient to study decentralization only in political terms. Any policy that leads to decentralization at the political level may not ensure the same result at the socio-economic level. Concessions provided by the state such as flexible labor and environmental laws, tax and duty rebates and cheap acquisition of land can disrupt social cohesion. These conditions often hurt the interest of diverse and economically different located masses in the society. Therefore, the study aims to explore this aspect of decentralization.

Related to this is the study of structural constraints in which the states have to function. Considering the fact that the states cannot depend on either agriculture or service sector and have to provide concessions if it wants to acquire crucial funds for development, the situation becomes grim. In this context, it becomes vital to see how a policy of inclusive growth can be worked out in a federal polity. It is argued, that devolution of powers at the lowest level through federalism can be the key to such a problem.

The methodology undertaken for this research is through a case study of SEZs. Therefore, chapters two and three extensively study the concept of Special Economic Zones. The second chapter explores the genesis and the nature of Special Economic Zones by looking at the meaning and its evolution. It then looks at this concept from the specificities of Indian context. Special Economic Zones dating back to the Roman times are a variant of Free Trade Zones. Three main characteristics, which define these zones, are they are duty free areas, offering a package of incentives, and undertaking productive and manufacturing activities with the financial aid of foreign and domestic private investors.

The concept of free trade zone became popular in 1950s and 1960s in most of the developing countries. It is argued that this policy came to be adopted by countries where import substitution policy failed to generate a competitive industrial sector. Therefore, they adopted an alternative strategy of export led growth. Since it was not possible for the country to adopt the policy of export led growth in its fullest sense, which meant embracing neo-liberal policies, it discovered a middle path in the form of Free Trade Zones. This holds true also for India, where special economic zones are being envisaged as growth centers to augment the economy by reaping the benefits of open economy, while making comparatively fewer changes in the status quo.

SEZs in India are adaptations of those in China. However, India was the first Asian country to have ever experimented with the concept of trade zones as early as 1965. While tracing the evolution of the policy it shows how the changing economic scenario in India led to full-fledged formulation of SEZ policy. It is argued that adoption of the policy was partially possible because of the growing political might of State Governments. Further, it also presents how SEZs have become a very important strategy for achieving higher rates of growth for the ruling party at the centre.

A discussion of the characteristics of SEZs such as size, location, type, role focus area, physical manifestation of the zone and different types of financial participation is undertaken to understand SEZ in Indian context. These characteristics also become

crucial in analyzing political and socio-economic implications of the policy. This is followed by a comprehensive study of the institutional framework provided in the SEZ Act. The idea is to look at the SEZ authorities created by the Act and the distribution of powers and responsibilities between the states as well as the central government. It is argued that a lot of stress is laid on the economic functions to be performed by the perspective authorities within the zone. However, keeping in view the profit making nature of the zones, the Act pays little heed to the political and social functions of the authority. Lastly, the procedure for establishing SEZ is studied to understand the role played by governments at different level. It also attempts to find out, how flexible is the procedure for approving SEZs, which have the capacity to affect lives of many.

The third chapter seeks to uncover the economic rationale and political justifications for adopting the policy of SEZs. The government of India wants to achieve rapid inclusive growth. A policy that ensures both rapidity of growth and inclusion of all would an appropriate policy. This is an attempt to show how SEZs fit into this logic of government by enlisting a number of economic advantages offered by SEZs. The advantages are promotion of exports of goods and services, generation of additional economic activities, promotion of investment from domestic and foreign sources, creation of employment and development of infrastructure. These economic advantages as evident by international experience help in achieving faster all-in compassing growth.

In addition, the financial constraint faced by states to develop themselves has also been discussed. Continuing from the first chapter, it is argued with the help of several empirical studies, how adopting SEZs has become an imperative for the states. This is because the transfers from the centre has become increasing inadequate, the states are experiencing deficit and are buried under huge debt that rules out further borrowing. Consequently, SEZ bring private investments that help in generating employment, building infrastructure and earning foreign exchange thus become a viable option. However, when an economic crisis emerges, in this case the inability of the states to fund themselves, a number of solutions exist. Why a specific policy of SEZs is adopted in the presence of other available options can only be understood by looking at the political

dynamics of the country. Therefore, the second part of the chapter looks into the political reasons of adopting SEZ policy. By surveying the literature on the autonomy of Indian state, it is suggested, that various pulls and pressures always act upon the state. They can be in the form of social groups, economic classes, external actors and structures and state elites, playing an important role in affecting any policy formulation. Therefore, at any given time a multitude of factors are present in determining the actions of the state. No single factor can substantively provide the rationale for any such action.

However, in this backdrop, to argue that the SEZ policy is formulated only to favor the capitalist is to overlook an important dimension. Socialist countries like China and states like Kerala and West Bengal in India have adopted SEZ policy. Similarly, Goa a vibrant economy has been able to demand the scrapping of the SEZs. This shows that the utility as well as the need for such a policy exists. Concurrently, it is also argued that Congress is facing a predicament. On one hand, it attempts to implement the National Common Minimum Program and on the other, the leadership has made a choice to follow policies, which are pro-globalization. This is because the government has realized that if the usual approach towards growth is adopted, achieving the set targets would not be possible. Therefore, Congress is trying to reconcile between economic reforms that benefit the elite and upper middle class and the poor who have been losers in the process. This has sharply brought into focus the conflict between economic growth and equity. It is argued that both are equally important and a balance between the two needs to be targeted. Therefore, what becomes more important in the context of SEZs is to see how an inclusive growth strategy can be formulated in a federal polity.

Chapter 4, with the help of SEZ policy, seeks to explore level of decentralization at legal politico level in the Indian federalism. It begins by reiterating the argument made in the first chapter that decentralization has taken roots in the Indian federalism owing to two most important political processes. These are fragmentation and federalization in the political parties and economic reforms. These two processes have augmented autonomy exercised by the state government. The next part of the chapter tests this hypothesis by examining the SEZs. At the legislative level, SEZ Act is a path breaking legislation as it

allows the state government to be in charge of every aspect of SEZs. However, at the same time, instances of the center overriding the powers of the state are also seen.

In the case of executive process of SEZs, the act seems to transfer more responsibilities to the states as compared to power and resources. In the case of establishing SEZs, it is argued that the very agency of the states has been evoked. This is because the states now have to compete with each other for attracting foreign funds. At the same time, the presence of the third tier in functioning of the zones is completely ignored. This can potentially lead to reversal of decentralization. It also suggests therefore, that a combination of both the decentralizing as well as centralizing tendencies can be observed through the policies of SEZs.

The fifth chapter looks at the issue of decentralization from non-territorial perspective. It argues that, to comprehensively evaluate the level of decentralization within the Indian polity, there is a need to look beyond the politico-legal level and analyze the same at socio-economic level. This is needed, as federalism also refers to a way of co-existence amidst disparities and diversities. In this context, the growth strategy of SEZs is evaluated to see how far it provides inclusion as well as empowerment of the masses. In other words, it seeks to find out how far this policy fits compatibly in the broader framework of UPA's policy programme of inclusive growth. Inclusive growth, not just aims at achieving higher rate of economic growth but at the same time ensures inclusion of all. For the same the government has listed out several areas that need to be targeted. They are employment generation, higher growth rate of agriculture, developing infrastructure, promoting health and education, focus on weaker section and increasing the level of private investment. These targets are to be achieved through the combined contribution of the public and the private sector.

The socio-economic impact of SEZs is studied through the issues of land, labor and environment. Simultaneously, governments' effort in mitigating the problems arising out of the implementation of the SEZ policy is examined. It is argued that government has made substantial effort in transforming an aggressive growth strategy into a more

acceptable, benefiting, and inclusive policy. However, the policy is at a nascent stage and a lot needs to be done, to make it into a more holistic policy. Consequently, despite the efforts made by the government its impact on the Indian polity, especially on those from the weaker section is not very conducive. Lastly, it argues that the model proposed by left parties is the best way to formulate a more conducive growth strategy in a federal polity.

Thus to answer the question of whether liberalization has led to decentralization, one needs to take into consideration an interplay of number of factors. What emerges is not a complete picture of centralization or decentralization. Indian federalism presents both the tendencies of centralization and decentralization on various accounts. If an analysis is done at institutional level clearly the enhanced autonomy and active role of the state government in today's economy to grow and prosper becomes evident. However, certain issues still needs to be addressed such as the neglect of third tier and further transfer of administrative powers and not just responsibilities to the states.

At the socio-economic level, scholars are increasingly pointing towards the growing disparity and divisions within the society. The plan itself admits to the failure of the government to bridge the gap. Consequently, the plan proposes a strategy for inclusive growth in various arenas. However, despite these efforts an increase in economic growth has not been able to mitigate the problem. The participation as well as distribution of benefits to the weakest section of the society, is not taking place. There has also been a tendency to undertake developmental projects at the cost of the poor and disadvantaged. In this scenario, the achievement of the political decentralization gets diluted. There is a strong need to give shape to SEZ policy to empower the masses so that not just socio economic but political decentralization also becomes meaningful.

The policy of SEZs is neither a panacea nor a disease. A non-biased analysis of the concept of SEZ would show that it is extremely beneficial in terms of augmenting investment, employment, infrastructure and foreign exchange in the country. However, like any other policy it is not foolproof. Seldom has it had a negative impact on labor,

environment and land. However, these effects are common to all developmental projects and industrial townships. While criticizing any aspect of SEZs, it is important to see whether the idea of industrial townships and existing situations in the country are criticized in general or specific problems emerging due to the implementation of SEZ policy are being criticized. For instance, the plight of labor in unorganized sector is not much different from that feared for those employed in SEZs; similarly, the problem of environmental pollution and acquisition of land holds true for any industrial township.

Therefore, if we are criticizing SEZs because they are part of the larger problems of the developmental process, then there is a need to look for alternatives to replace large-scale industrialization. The only alternative seems to be the model proposed by Gandhi of self-sufficient decentralized village economy. However, this is not a justification for SEZ policy. Glaring concerns related to tax concessions, effective implementation of R & R policy, flexible labor laws, proper town planning and the need to empower the third tier is very much present.

In this context, for the success of any policy the role of the political authorities is very vital. Even though SEZs are in a nascent stage, the need for a strong political will and effective formulation and implementation of the policy is required. Within this, the most important aspect becomes that of designing an inclusive growth strategy in a federal polity. As mentioned earlier, the solution lies in the concept of federalism itself. That is, only devolution of powers by political authorities at the highest level to the lowest level can ensure inclusive growth. Mani Shankar Aiyar adeptly puts it, 'for Inclusive Growth, we need to hitch the horse of accelerated growth to the wagon of participative development'.¹ This growth, taking place through participation of all can affirm social cohesion and harmony of interest. Only then can growth be meaningful. Hence, much depends on the political will to effectively implement and ensure inclusive growth through involvement of all.

¹ Aiyar, Mani Shankar 'Inclusive Growth through Inclusive Governance', *The Hindu*, 10th June, 2008.

ANNEXURE – A

(As on 10.07.08)

Fact sheet on Special Economic Zones

SEZ Act 2005	<ul style="list-style-type: none"> ▪ Passed by parliament in May 2005 ▪ Recd. Presidential assent on 23rd June 05 ▪ Came into effect on 10th Feb 06 supported by the SEZ Rules
No. of valid formal approvals	<ul style="list-style-type: none"> ▪ 240 (out of 462)
No. of Notified SEZs (As on date –15.5.08)	<ul style="list-style-type: none"> ▪ 222 (out of 462)
Land requirement:	<p>Ground Realities:</p> <p>Total Land in India : 2973190 sq km Total Agri Land in India: 1620388 sq km (54.5%)</p> <p>SEZs formally approved and notified –Approx 642 sq km Valid In principle approvals (135) Approx. 1213 sq km</p> <p>Total Area for proposed SEZs (FA+IP) – Approx. 1855 sq km which would not be more than 0.061% of the total land area and not be more than 0.112% of the total Agri Land in India.</p> <p>Formal Approvals incl. notified SEZs:</p> <ul style="list-style-type: none"> ▪ Approx 64222 hectares ▪ Proposals from SIDCs/St. Govt. Agencies: 101 <p>Land requirement for the 101 proposals: 20503 ha</p>
No. of valid In principle approvals	135
DIRECT Investment made in notified SEZs	<ul style="list-style-type: none"> • Rs. 69,350 Crores (as of 31st March 2008)
DIRECT Employment created in notified SEZs (as of 31.3.08.)	<ul style="list-style-type: none"> ▪ 97993 persons (Direct Employment)- (all Incremental Employment generated after February 2006))
DIRECT Employment in Private/State Govt. SEZs which came into force prior to SEZ Act, 2005 (as of 31.3.08.)	<ul style="list-style-type: none"> ▪ 44768 persons (Direct Employment) – (Incremental emp. Since February 2006: 32,300 persons)
Employment in 7 SEZs established by the Central Government (as of 31.3.08.)	<ul style="list-style-type: none"> ▪ 1,93,474 persons (Incremental employment: 71,238 persons)
Total INCREMENTAL EMPLOYMENT generated in SEZs since Feb. 2006	<ul style="list-style-type: none"> • Total incremental employment in SEZs as a whole: 2,01,531 persons <p>(Out of the total employment of 3,36,235 Lakh persons in SEZs as a whole)</p>
Physical Exports in 2006-07	<ul style="list-style-type: none"> ▪ Rs. 34615 Crore (Growth of 52% over Rs. 22840 Crore in 2006-07)
Physical Exports effected during 2007-08	<ul style="list-style-type: none"> ▪ Rs. 66638 crores (92% growth over 2006-07) <ul style="list-style-type: none"> ○ Physical exports was 84% of turnover ○ Deemed exports – 11% of total turnover ○ DTA Sales – 5% of total turnover
	<ul style="list-style-type: none"> • Overall Growth of exports of 381% over past four years (2003-04)
Export projection for 2008-09	<ul style="list-style-type: none"> • Rs. 1, 25, 950 crore.

(Source: SEZ Authority, Ministry of Commerce and Industry, Government of India, Website: sezindia.nic.in)

ANNEXURE- B

Incentives and Concessions given to the SEZ Investors in India:

PREFERENTIAL TREATMENT:

Incentive to the Units:

• Foreign Direct Investments

1. 100% FDI is freely allowed in manufacturing sector in SEZ units under automatic route, except arms
2. and ammunition, explosive, atomic substance, narcotics and hazardous chemicals, distillation and
3. brewing of alcoholic drinks and cigarettes, cigars and manufactured tobacco substitutes
4. No cap of foreign investments for SSI reserved items

• Off-Shore Banking Units (OBUs)

1. Setting up of OBUs allowed in SEZs
2. OBUS are entitled for 100% income tax exemption for 3 years and 50% for next 2 years

• Banking / External Commercial Borrowings (ECBs)

1. ECBs by units upto US\$ 500 million a year allowed without any maturity restrictions
2. Freedom to bring in export proceeds without any time limit
3. Flexibility to keep 100% of export proceeds in EEFC account and freedom to make overseas payment
4. from such account
5. Exemption from interest rate surcharge on import finance
6. SEZ units allowed to write-off unrealized export bills
7. Exemption from interest rate surcharge on import finance

• Central Sales Tax

1. Exemption from CST on sale or purchase of goods from DTA to a unit in a SEZ or on transactions between units in SEZs required for setting up, operation and maintenance of units

• Service Tax

1. Exemption from service tax to SEZ units

• Sales to DTA

1. DTA sales can be undertaken subject to achievement of positive NFE. Net Foreign Exchange (NFE) shall be calculated cumulatively for a period of 5 years from the commencement of commercial production.
2. Exemption from capital gains on transfer of an industrial unit from urban area to a SEZ
3. Drawback or such other benefit as may be admissible from time to time on goods and services admitted from the DTA for setting up, operation and maintenance of units
4. All exports from the DTA to the Zone shall be exempt from state and local body taxes or levies as State Sales Tax, Sales Tax based levies, Sales Tax based levies, Value Added Tax, Octroi or Tax on entry of goods (In some states, exports made to educational institutions, hospitals, hotels, residential and /or commercial complexes, leisure and entertainment facilities or any other facilities as may be notified by the state government are not exempt)

Incentive to the Developers:

- Developers of SEZs may import or procure goods from DTA without payment of duty for development,
- operation or maintenance of SEZ
- Exemption from Central Sales Tax (CST) on supply of goods from the DTA for development, operation and maintenance of SEZs
- Income tax exemption for a block of 10 years in the first 15 years of operation
- Drawback or such other benefits as may be admissible from time to time on supply of goods from DTA for development, operation and maintenance of SEZs
- Investment income in the form of dividends, interest or long term capital gains, of an infrastructure capital company from investments made in an enterprise engaged in the development, operation or maintenance of a SEZ are exempt from tax
- Foreign investment permitted
- Service tax exemption on services provided to a developer or to a unit located in the SEZ region
- State government shall –

1. Provide exemption from electricity duty or taxes on sale of self generated or purchased electric power
 2. for use in processing area of an SEZ
 3. allow generation, transmission, distribution of power within a SEZ subject to the provisions of the
 4. electricity act
- With respect to each Special Economic Zone all such transactions between the Zones or within the Zone or both, including the transactions of land acquisition for development of the Zone between the developer or co developer and land owners and land transactions between the developers or co-developers and the units, carried out after declaration of the Zone by the Government of India, shall be exempt from the following State taxes, cess and levies namely:
 1. Purchase tax, Sales tax and Turnover tax
 2. Specified sales (Lease tax) in respect of lease of goods
 3. Stamp duty for the first transaction between the Developer or co-developer and the land-owner and the first transaction
 4. between the Developer or co-developer and the Units
 5. Registration fee for the first transaction between the Developer or co-developer and the land-owner and the first transaction
 6. between the Developer or co-developer and the Units
 7. Land assessment tax
 8. Electricity duty and tax (Only for sales to Units in processing area)
 9. Water pollution cess
 10. Works Contract tax
 - Any activity or transaction in the Zone, which is liable for entertainment duty under the Bombay Entertainments Duty Act, 1923 and Luxury Tax under the Maharashtra Tax on Luxuries Act, 1987 shall not be liable to such tax.

The fiscal benefits shall be applicable for a period of 25 years from the date of notification of the zone by the Government of India or such extended period as may be decided by the State Government

FREEDOM TO THE INVESTORS:

- 1) freedom to repatriate and remit profit
- 2) Foreign investment permitted
- 3) No foreign ownership restrictions

HASSLE FREE ADMINISTRATIVE ADVANTAGES:

1. Single window clearance for Central and State level approvals.
2. Centralized administration e.g. under SEZ commissioner to simplify and unify administrative procedures regarding investment and operation in the zone.
3. Exemption from public hearing under environment Impact Assessment Notification.

LOCAL ADVANTAGES, FACILITIES AND PROVISIONS:

1. Cheap labor Cost
2. Provision of infrastructure and utilities.
3. provision of housing and various amenities; warehousing and supporting services
4. Freedom to set up Off-shore Banking Units

(Source: Compiled by information available on the Website: <http://sezindia.nic.in/welcome.htm> (date of access: 10/11/07) and 'India SEZ Summit 2006: Driving Investments and Exports: Building Growth Centres', Confederation of Indian Industries, New Delhi, Website: http://cii.in/documents/WTO/SEZ_Background_Paper.pdf, date of access: 1/01/2008)

ANNEXURE- C

Differences between EPZs and SEZs

Issues	India's SEZ	India'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 appear 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 years in first 8 years of operations. However, under section 10a of the income tax act, the concession was to be phased out by 2009	SEZs offer more attractive tax benefits than EPZs
Retention of foreign exchange earnings	Retain 100% foreign exchange earnings in Exchange Earner Foreign Currency Account (EEFC).	Retain 70% foreign exchange earnings 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 Earning as % of exports (NFEP) requirements	No minimum EP required. Positive NFEP required (varies across industries and states)	Minimum EP and NFEP required. (varies across industries and states)	Companies in SEZ enjoy more leeway in meeting export performance requirements.
Duty recovery in case of failure to achieve positive NFEP	Duty recovery is in proportion to shortfall	Full duty recovery is imposed	Lesser penalty for SEZs failing to achieve positive NFEP
DTA* sales	Unlimited DTA sales on full duty	Only 50% of exports qualify for DTA sales	SEZs enjoy greater access to domestic market
Duty free imported raw material	Allowed. These duty free materials are to be utilized over 5 years	Allowed, but duty free materials are to be utilized over 1 year.	More flexibility in production and inventory planning for companies in SEZs.
Certifications of Imports	Imports on self certification Basis	Imports require attestation of Development Commissioner	Simplified customs procedures facilitate movement of imports

Customs Inspection	No routine examination of import/export cargo by Customs	Routine customs inspections of import/export cargo	into SEZs 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.

Source: SEZ Authority, Ministry of Commerce and Industry, Government of India Available at sezindia.nic.in (Date of Access: 5/06/06)

ANNEXURE-D

SPECIAL ECONOMIC ZONES ACT- 2005

THE GAZETTE OF INDIA
EXTRAORDINARY
PART II – SECTION I
PUBLISHED BY AUTHORITY
NEW DELHI, THURSDAY, JUNE 23, 2005
MINISTRY OF LAW AND JUSTICE
(Legislative Department)

New Delhi, the 23rd June, 2005/Asadha 2, 1927 (Saka)

The following Act of Parliament received the assent of the President on the 23rd June, 2005, and it hereby published for general information: -

THE SPECIAL ECONOMIC ZONES ACT, 2005
No. 28 OF 2005

[23rd June, 2005]

An Act to provide for the establishment, development and management of the Special Economic Zones for the promotion of exports and for matters connected therewith or incidental thereto.

Be it enacted by Parliament in the Fifty-sixth Year of the Republic of India as follows:-

CHAPTER-I PRELIMINARY		
	<p>1. (1) This Act may be called the Special Economic Zones Act, 2005.</p> <p>(2) It extends to the whole of India.</p> <p>(3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint, and different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.</p>	Short title, extent and commencement.
Definitions.	<p>2. In this Act, unless the context otherwise requires,-</p> <p>(a) "appointed day" with reference to a Special Economic Zone means the date on which the Special Economic Zone is notified by the Central Government under sub-section (1) of section 4;</p> <p>(b) "Approval Committee" means an Approval Committee constituted under sub-section (1) of section 13;</p> <p>(c) "authorised operations" means operations which may be authorised under sub-section (2) of section 4 and sub-section (9) of section 15;</p> <p>(d) "Authority" means a Special Economic Zone Authority constituted under sub-section (1) of section 31;</p> <p>(e) "Board" means the Board of Approval constituted under sub-section (1) of section 8;</p> <p>(f) "Co-Developer" means a person who, or a State Government which, has been granted by the Central Government a letter of approval under sub-section (12) of section 3;</p> <p>(g) "Developer" means a person who, or a State Government which, has been granted by the Central Government a letter of approval under sub-section (10) of section 3 and includes an Authority and a Co-Developer;</p> <p>(h) "Development Commissioner" means the Development Commissioner appointed for one or more Special Economic Zones under sub-section (1) of section 11;</p> <p>(i) "Domestic Tariff Area" means the whole of India (including the territorial waters and continental shelf) but does not include the areas of the Special Economic Zones;</p>	

	<p>(j) "entrepreneur" means a person who has been granted a letter of approval by the Development Commissioner under sub-section (9) of section 15;</p> <p>(k) "existing Special Economic Zone" means every Special Economic Zone which is in existence on or before the commencement of this Act (...)</p>	
	<p>CHAPTER II</p> <p>ESTABLISHMENT OF SPECIAL ECONOMIC ZONES</p>	
<p>Procedure for making Proposal to establish SEZs</p>	<p>3. (1) A Special Economic Zone may be established under this Act, either jointly or severally by the Central Government, State Government, or any person for manufacture of goods or rendering services or for both or as a Free Trade and Warehousing Zone.</p> <p>(2) Any person, who intends to set up a Special Economic Zone, may, after identifying the area, make a proposal to the State Government concerned for the purpose of setting up the Special Economic Zone.</p> <p>(3) Notwithstanding anything contained in sub-section (2), any person, who intends to set up a Special Economic Zone, may, after identifying the area, at his option, make a proposal directly to the Board for the purpose of setting up the Special Economic Zone: Provided that where such a proposal has been received directly from a person under sub-section, the Board may grant approval and after receipt of such approval, the person concerned shall obtain the concurrence of the State Government within the period, as may be prescribed.</p> <p>(4) In case a State Government intends to set up a Special Economic Zone, it may after identifying the area, forward the proposal directly to the Board for the purpose of setting up the Special Economic Zone: Provided that the Central Government may:- (a) after consulting the State Government concerned; (b) without referring the proposal for setting up the Special Economic Zone to the Board; and (c) after identifying the area; <i>suo moto</i> set up and notify the Special Economic Zone (...)</p> <p>The State Government may, on receipt of the proposal made under sub-section (2), forward the same together with its recommendations to the Board within such period as may be prescribed.</p> <p>(7) Without prejudice to the provisions contained in sub-section (8), the Board may, after receipt of the proposal under sub-section (2) to (4), approve the proposal subject to such terms and conditions as it may deem fit to impose, or modify or reject the proposal.</p> <p>(8) The Central Government may prescribe the following requirement for establishment of a Special Economic Zone, namely:- (a) the minimum area of land and other terms and conditions subject to which the Board shall approve, modify or reject any proposal received by it under sub-section (2) to (4); and (b) the terms and conditions, subject to which the Developer shall undertake the authorised operations and his obligations and entitlements. Provided that different minimum area of land and other terms and conditions referred to in clause (a) may be prescribed by the Central Government for a class or classes of Special Economic Zones.</p> <p>(9) If the Board,- (a) approves without any modification, the proposal received under sub-section (2) to (4), it shall communicate the same to the Central Government; (b) approves with modifications the proposal received under sub-section (2) to (4), it shall, communicate such modifications to the person or the State Government concerned and if such modifications have been accepted by such person or the State Government, the Board shall communicate the approval to the Central Government; (c) rejects the proposal, received under sub-section (2) to (4), it shall record the reasons therefore and communicate the rejection to the Central Government which</p>	

	shall intimate to the State Government or the person concerned. (10) The Central Government shall, on receipt of communication under clause (a) or clause (b) of sub-section (9), grant, within such time as may be prescribed, a letter of approval (...)	
	CHAPTER III CONSTITUTION OF BOARD OF APPROVAL	
Constitution of Board of Approval	8. (1) The Central Government shall, within fifteen days of the commencement of this Act, by notification, constitute, for the purposes of this Act, a Board to be called the Board of Approval. (2) The Board shall consist of- (a) an officer not below the rank of an Additional Secretary to the Government of India in the Ministry or Department of the Central Government dealing with Commerce - Chairperson, ex officio; (b) two officers, not below the rank of a Joint Secretary to the Government of India, to be nominated by the Central Government to represent the Ministry or Department of the Central Govt. dealing with revenue – Members, ex officio; (c) one officer not below the rank of Joint Secretary to the Government of India to be nominated by the Central Government the Ministry or Department of the Central Government dealing with economic affairs (financial services) – Members, ex officio; (d) such number of officers, not exceeding ten, not below the rank of the Joint Secretary to the Government of India, to be nominated by the Central Government to represent the Ministries or Departments of the Central Government dealing with commerce, industrial policy and promotion, science and technology, small scale industries and agro and rural industries, home affairs, defence, environment and forests, law, overseas Indian affairs and urban development - Members, ex officio; (e) a nominee of the State Government concerned - Member, ex officio; (f) the Director General of Foreign Trade or his nominee - Member, ex officio; (g) the Development Commissioner concerned - Member, ex officio; (h) a Professor in the Indian Institute of Management, being a society registered under the Societies Registration Act, 1860 or the Indian Institute of Foreign Trade, being a society registered under the Societies Registration Act, 1860, as may be, nominated by the Central Government - Member, ex officio; (...)	21 Of 1860
	CHAPTER IV DEVELOPMENT COMMISSIONER	
	11. (1) The Central Government may appoint any of its officers not below the rank of Deputy Secretary to the Government of India as the Development Commissioner of one or more Special Economic Zones. (2) The Central Government may appoint such officers and other employees as it considers necessary to assist the Development Commissioner in the performance of his functions in the Special Economic Zones established by a Developer (other than Central Government) under this Act on such terms and conditions as it deems fit. (3) Every Development Commissioner, officers and other employee shall be entitled to such salary and allowances and subject to such terms and conditions of service in respect of leave, pension, provident fund and other matters as may, from time to time, be specified by the Central Government (...)	Development Commission
	CHAPTER V SINGLE WINDOW CLEARANCE	
Constitution of Approval Committee	(...) (2) Every Approval Committee shall consist of – (a) the Development Commissioner - Chairperson, ex officio; (b) two officers of the Central Government to be nominated by the Central Government - Members, ex officio; (c) two officers of the Central Government to represent the Ministry or Department dealing with revenue – Members, ex officio; (d) one officer of the Central Government to be nominated by that Government to represent the Ministry or Department dealing with the economic affairs (financial	

	<p>services) – Members, ex officio; (e) two officers of the State Government concerned to be nominated by that Stated Government – Member, ex officio; (f) a representative of the Developer concerned – Special invitee. (3) For the purpose of exercising its powers and performing its functions, the Approval Committee may invite to its meetings, such persons as the Committee deems fit, whose assistance or advice it may consider necessary. (...)</p>	
	<p>CHAPTER VII SPECIAL ECONOMIC ZONE AUTHORITY</p>	
Constitution of the Authority	<p>31. (1) The Central Government shall, by notification in the Official Gazette, constitute, for every Special Economic Zone established by it before the commencement of this Act or which may be established by it after such commencement by the Central Government, an Authority to be called the (name of the Special Economic Zone) Authority to exercise the powers conferred on, and discharge the functions assigned to, it under this Act (...) (2) Every Authority shall be a body corporate by the name aforesaid, having perpetual succession and a common seal, with a power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue and be sued. (3) The head office of every Authority shall be at such place as the Central Government may specify in the notification referred to in sub-section (1). (4) Any Authority may, with the previous approval of the Central Government, establish branch offices at other places in India. (5) Every Authority shall consist of - (a) the Development Commissioner of the Special Economic Zone over which the Authority exercises its jurisdiction - Chairperson, ex officio; (b) two officers of the Central Government to be nominated by that Government having knowledge of, or experience in, dealing with matters relating to Special Economic Zones - Members, ex officio; (c) an officer of the Government of India in the Ministry or Department dealing with Commerce on matters relating to Special Economic Zone - Member, ex officio; (...)</p>	
	<p>34. (1) Subject to the provisions of this Act, it shall be the duty of each Authority to undertake such measures as it thinks fit for the development, operation and management of the Special Economic Zone for which it is constituted. (2) Without prejudice to the generality of the provisions of sub-section (1), the measures referred to therein may provide for - (a) the development of infrastructure in the Special Economic Zone; (b) promoting exports from the Special Economic Zone; (...)</p>	Functions of the Authority
Power to modify provisions of this Act or other enactments in relation to Special Economic Zones.	<p>49. (1) The Central Government may, by notification, direct that any of the provisions of this Act (other than sections 54 and 56) or any other Central Act or any rules or regulations made thereunder or any notification or order issued or direction given thereunder (other than the provisions relating to making of the rules or regulations) specified in the notification-- (a) shall not apply to a Special Economic Zone or a class of Special Economic Zones or all Special Economic Zones; or (b) shall apply to a Special Economic Zone or a class of Special Economic Zones or all Special Economic Zones only with such exceptions, modifications and adaptation, as may be specified in the notification. Provided that nothing contained in this section shall apply to any modifications of any Central Act or any rules or regulations made thereunder or any notification or order issued or direction given or scheme made thereunder so far as such modification, rule, regulation, notification, order or direction or scheme relates to the matters relating to trade unions, industrial and labour disputes, welfare of labour including conditions of work, provident funds, employers' liability, workmen's compensation, invalidity and old age pensions and maternity benefits applicable in any Special Economic Zones. (...)</p>	

	<p>50. The State Government may, for the purposes of giving effect to the provisions of this Act, notify policies for Developers and Units and take suitable steps for enactment of any law:-</p> <p>(a) granting exemption from the State taxes, levies and duties to the Developer or the entrepreneur;</p> <p>(b) delegating the powers conferred upon any person or authority under any State Act to the Development Commissioner in relation to the Developer or the entrepreneur.</p>	<p>Power of the State government to grant exemption</p>
	<p>51. (1) The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act. (...)</p>	<p>Act to have overriding effect</p>

(Source: SEZ Authority, Ministry of Commerce and Industry, Government of India, Website: sezindia.nic.in, date of access: 15/07/08)

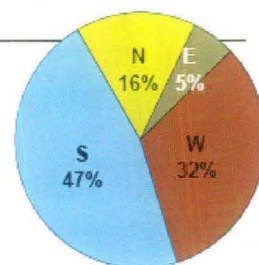
Disclaimer :- The above is an abridged version of the SEZ ACT 2005. The content shown is for general reference only. Please refer to the original official document published by Department of Commerce to ascertain the facts.

ANNEXURE- E
(As on 10.07.2008)

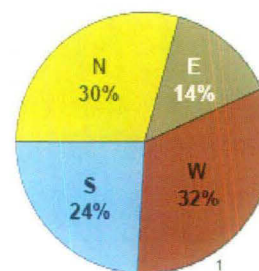
SEZs : Statewise Distribution

State	Formal approvals	In-principle approvals	Notified SEZs
Andhra Pradesh	66	8	40
Chandigarh	2		1
Chattisgarh	1	2	
Delhi	2		
Dadra & Nagar Haveli	2	1	
Goa	7		2
Gujarat	27	8	10
Haryana	28	28	7
Himachal Pradesh		4	
Jharkhand	1		1
Karnataka	33	16	16
Kerala	11	2	8
Madhya Pradesh	8	6	2
Maharashtra	70	35	15
Orissa	8	6	1
Pondicherry	1		
Punjab	4	7	2
Rajasthan	4	11	1
Tamil Nadu	50	11	17
Uttar Pradesh	12	10	6
Uttaranchal	3	1	
West Bengal	11	15	1
GRAND TOTAL	341	171	130

Formal

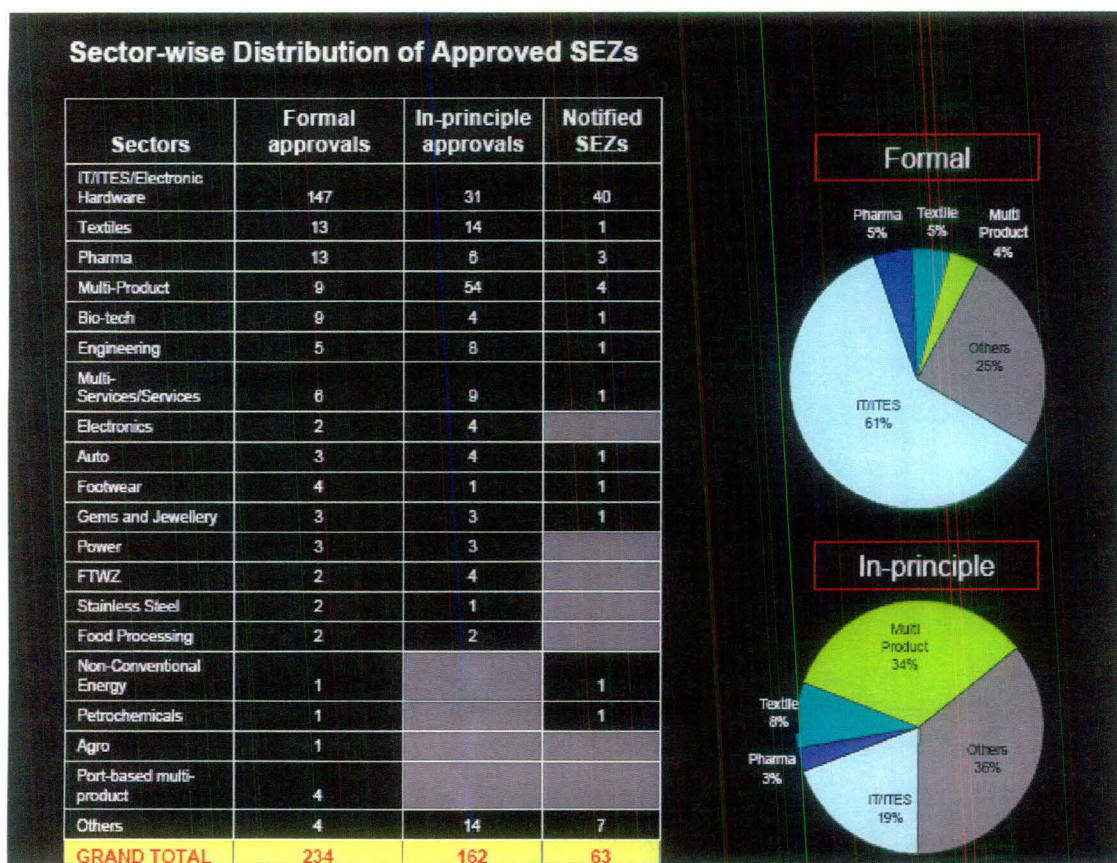


In-principle



(Source: SEZ Authority, Ministry of Commerce and Industry, Government of India, Website: sezindia.nic.in)

ANNEXURE- F
(As on 10.07.2008)



(Source: SEZ Authority, Ministry of Commerce and Industry, Government of India, Website: sezindia.nic.in)

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